

<p style="text-align: right;">Page 1</p> <p>1 2 UNITED STATES OF AMERICA 3 COMMODITY FUTURES TRADING COMMISSION 4 -----X 5 In the Matter of: 6 7 CATALYST CAPITAL ADVISORS, LLC 8 -----X 9 10 140 Broadway 11 New York, New York 12 13 October 27, 2017 14 9:30 a.m. 15 16 DEPOSITION of EDWARD S. WALCZAK, 17 the Witness herein, taken by the Commodity 18 Futures Trading Commission, held at the 19 above-noted time and place, before a Notary 20 Public of the State of New York. 21 22 23 24 25</p>	<p style="text-align: right;">Page 3</p> <p>1 2 MR. WASSERMAN: Good morning, 3 Mr. Walczak. My name is Sam Wasserman. 4 This is Candice Aloisi and Mike 5 Cazakoff, also staff with the division 6 of enforcement with the Commodity 7 Futures Trading Commission. We also 8 have staff members of the SEC present 9 and on the phone, I will let them 10 introduce themselves. 11 MR. SHANK: Jeff Shank, division 12 of enforcement. With me is Jake 13 Schmidt, David Benson, also with the 14 division of enforcement, and Terry 15 Moran, who is part of our national exam 16 program. 17 MR. WASSERMAN: Mr. Walczak, 18 before the interview, I provided you 19 and your counsel with our statement to 20 persons providing information to the 21 CFTC. Have you had a chance to review 22 that with your counsel? 23 THE WITNESS: Yes, I have. 24 MR. WASSERMAN: Do you have any 25 questions about that?</p>
<p style="text-align: right;">Page 2</p> <p>1 2 APPEARANCES: 3 UNITED STATES COMMODITY FUTURES 4 TRADING COMMISSION 5 Division of Enforcement 6 140 Broadway 7 19th Floor 8 New York, New York 10007 9 BY: SAMUEL C. WASSERMAN, ESQ. 10 CANDICE ALOISI, ESQ. 11 MICHAEL J. CAZAKOFF, INVESTIGATOR 12 13 UNITED STATES SECURITIES AND 14 EXCHANGE COMMISSION 15 175 West Jackson Boulevard 16 Suite 1450 17 Chicago, Illinois 60604 18 BY: JEFFREY SHANK, ESQ. 19 JAKE SCHMIDT, ESQ. 20 DAVID BENSON, ESQ. 21 TERRENCE MORAN, SENIOR INVESTMENT 22 SPECIALIST 23 (VIA TELEPHONE) 24 LAZARE, POTTER, GIACOVAS & MOYLE, LLP 25 Attorneys for the Witness 875 Third Avenue Floor 28 New York, New York 10022 BY: JAMES F. MOYLE, ESQ. JACOB ENGLANDER, ESQ. ZILIAK LAW, L.L.C. Co-Counsel for the Witness 141 West Jackson Boulevard Suite 4048 Chicago, Illinois 60604 BY: ZACHARY J. ZILIAK, ESQ.</p>	<p style="text-align: right;">Page 4</p> <p>1 2 THE WITNESS: No. 3 MR. WASSERMAN: Can we mark that 4 as Exhibit 1, please. 5 (Statement to persons was marked 6 Commission Exhibit 1 for 7 identification, as of this date.) 8 MR. SHANK: And also prior to 9 the testimony, I had provided you with 10 SEC form 1662. Did you have an 11 opportunity to review that form? 12 THE WITNESS: Yes, I did. 13 MR. SHANK: That form we can 14 mark as Exhibit 2, that would be great. 15 And then also we will mark as Exhibit 3 16 our SEC form 1661, which is our 17 disclosure form for regulated entities. 18 (Supplemental information for 19 persons was marked Commission Exhibit 2 20 for identification, as of this date.) 21 (Supplemental information for 22 entities was marked Commission Exhibit 23 3 for identification, as of this date.) 24 MR. SHANK: Do you have any 25 questions regarding any of those forms?</p>

<p style="text-align: right;">Page 5</p> <p>1</p> <p>2 THE WITNESS: No, I do not.</p> <p>3 MR. WASSERMAN: Mr. Walczak,</p> <p>4 your testimony today is part of an</p> <p>5 investigation in the matter of Catalyst</p> <p>6 Capital Advisors to determine whether</p> <p>7 there have been violations of certain</p> <p>8 provisions of the Commodity Exchange</p> <p>9 Act and regulations. However, the facts</p> <p>10 developed in this investigation might</p> <p>11 constitute violations of other federal,</p> <p>12 civil or criminal laws. Your testimony</p> <p>13 here today is not pursuant to a</p> <p>14 subpoena. Mr. Walczak, do you</p> <p>15 understand that you are here</p> <p>16 voluntarily and need not answer any</p> <p>17 questions, but if you do choose to</p> <p>18 answer questions, you must answer them</p> <p>19 truthfully?</p> <p>20 THE WITNESS: I understand.</p> <p>21 MR. SHANK: Let me just jump in,</p> <p>22 same exact thing, the same thing</p> <p>23 applies for us. We also do not have a</p> <p>24 subpoena in this matter, there's no</p> <p>25 formal order of investigation, you are</p>	<p style="text-align: right;">Page 7</p> <p>1 Walczak</p> <p>2 MR. ZILIAK: Zachary Ziliak of</p> <p>3 Ziliak Law.</p> <p>4 MR. ENGLANDER: Jacob Englander</p> <p>5 from Lazare, Potter, Giacovas & Moyle.</p> <p>6 Q And are all three of these</p> <p>7 individuals representing you here today?</p> <p>8 A Yes, they are.</p> <p>9 Q One last administrative matter,</p> <p>10 Mr. Walczak, we control the record. If you</p> <p>11 want to go off the record, you can direct</p> <p>12 that request to me. That being said, we will</p> <p>13 move forward.</p> <p>14 MR. SHANK: I have one</p> <p>15 disclosure, too. Your testimony today</p> <p>16 has been requested by the staff as part</p> <p>17 of an informal inquiry in the matter of</p> <p>18 Catalyst Hedged Futures Strategy Fund</p> <p>19 to determine whether there have been</p> <p>20 violations of certain provisions of the</p> <p>21 federal securities laws. However, the</p> <p>22 facts developed in this investigation</p> <p>23 might constitute violations of other</p> <p>24 federal or state, civil or criminal</p> <p>25 laws. That's it.</p>
<p style="text-align: right;">Page 6</p> <p>1 Walczak</p> <p>2 here voluntarily. Do you understand</p> <p>3 that you need not answer any of our</p> <p>4 questions and you may leave at any time</p> <p>5 that you wish?</p> <p>6 THE WITNESS: I understand.</p> <p>7 E D W A R D W A L C Z A K , the Witness</p> <p>8 herein, having been first duly</p> <p>9 sworn by Catherine J. Berkery, a</p> <p>10 Notary Public in and for the State of</p> <p>11 New York, was examined and testified</p> <p>12 as follows:</p> <p>13 EXAMINATION BY</p> <p>14 MR. WASSERMAN:</p> <p>15 Q Mr. Walczak, can you state and</p> <p>16 spell your full name for the record, please?</p> <p>17 A Edward Stanley Walczak. The last</p> <p>18 name is spelled W-A-L-C-Z-A-K.</p> <p>19 Q Mr. Walczak, are you represented</p> <p>20 here by counsel today?</p> <p>21 A I am.</p> <p>22 MR. WASSERMAN: Would counsel</p> <p>23 please identify themselves?</p> <p>24 MR. MOYLE: James Moyle of</p> <p>25 Lazare, Potter, Giacovas & Moyle.</p>	<p style="text-align: right;">Page 8</p> <p>1 Walczak</p> <p>2 Q Mr. Walczak, can we start with</p> <p>3 some personal background? What's your</p> <p>4 educational history?</p> <p>5 A Sure. So I have a bachelor's of</p> <p>6 arts degree in physics and economics from</p> <p>7 Middlebury College in Vermont. And I have a</p> <p>8 master's degree in business administration</p> <p>9 from Harvard University.</p> <p>10 Q What year did you graduate</p> <p>11 Middlebury?</p> <p>12 A 1977.</p> <p>13 Q And Harvard?</p> <p>14 A 1983.</p> <p>15 Q And that was with an MBA you</p> <p>16 said?</p> <p>17 A Correct.</p> <p>18 Q And can you give us your</p> <p>19 employment history following your graduation</p> <p>20 from business school?</p> <p>21 A From business school? Okay.</p> <p>22 Following business school, I was employed by</p> <p>23 General Foods Corporation in the operations</p> <p>24 function. And you'll have to excuse me if I</p> <p>25 don't remember exact job titles, it's a long</p>

<p style="text-align: right;">Page 9</p> <p>1 Walczak</p> <p>2 time ago. And subsequent to General Foods,</p> <p>3 what happened next, I went to, I'm trying to</p> <p>4 remember the sequence of things, I went to</p> <p>5 work for Brach's Candy, but in between those</p> <p>6 two I worked for Metropolitan Life Insurance</p> <p>7 Company for a year.</p> <p>8 Q What did you do for General</p> <p>9 Foods?</p> <p>10 A For General Foods I was in</p> <p>11 operations. I served various functions,</p> <p>12 including facility maintenance director,</p> <p>13 production manager for one of their</p> <p>14 facilities and engineering supervisor as</p> <p>15 well.</p> <p>16 Q What does that mean,</p> <p>17 "engineering supervisor"?</p> <p>18 A I managed three or four project</p> <p>19 engineers in a manufacturing facility.</p> <p>20 Project engineers do things like coordinate</p> <p>21 the installation of production equipment,</p> <p>22 evaluate pay-backs on capital investments</p> <p>23 for the facility. So I had a team of roughly</p> <p>24 three or four engineers that worked for me.</p> <p>25 Q By "capital investments," you</p>	<p style="text-align: right;">Page 11</p> <p>1 Walczak</p> <p>2 engineering work, supply chain logistics. I</p> <p>3 mean, specifically the engineering position</p> <p>4 had, you know, again, engineers more</p> <p>5 specifically rather than the other</p> <p>6 functions.</p> <p>7 Q How long were you at Brach's</p> <p>8 Candy for and in what years, if you can</p> <p>9 remember?</p> <p>10 A I should have brought my resume</p> <p>11 along. Let's see. So I was in Chicago in</p> <p>12 19 -- I left Chicago in 1999, came to</p> <p>13 Chicago with General Foods in 1985. It would</p> <p>14 have been roughly, gosh -- I'm --</p> <p>15 Q If you can approximate. If you</p> <p>16 can't, that's fine.</p> <p>17 A I mean, I left Brach's Candy</p> <p>18 roughly in the year -- I would say year 2000</p> <p>19 after moving to Atlanta. So I was with them,</p> <p>20 oh, boy, six or seven years. I apologize,</p> <p>21 but I didn't review my resume and those are</p> <p>22 long -- days long behind me.</p> <p>23 Q What was your next position of</p> <p>24 employment after Brach's Candy?</p> <p>25 A Yes, so I went to work for a</p>
<p style="text-align: right;">Page 10</p> <p>1 Walczak</p> <p>2 mean investments in equipment and --</p> <p>3 A Machinery and so forth.</p> <p>4 Q And what did you do for Met</p> <p>5 Life?</p> <p>6 A Met Life I was a management</p> <p>7 trainee for a year in the sales function.</p> <p>8 Q Was that your only position at</p> <p>9 Met Life?</p> <p>10 A Yes.</p> <p>11 Q Moving to Brach's Candy, what</p> <p>12 did you do?</p> <p>13 A At Brach's Candy I had various</p> <p>14 positions again in the operating side of the</p> <p>15 business. So at one point I was a</p> <p>16 vice-president of engineering, at one point</p> <p>17 I was a maintenance director, facilities</p> <p>18 maintenance director again. At one point I</p> <p>19 was a supply chain -- vice-president of</p> <p>20 supply chain.</p> <p>21 Q What did the vice-president of</p> <p>22 engineering position entail?</p> <p>23 A VP of engineering at that time</p> <p>24 had very similar responsibilities to the</p> <p>25 function at General Foods. So supervising</p>	<p style="text-align: right;">Page 12</p> <p>1 Walczak</p> <p>2 company that went through a number of</p> <p>3 mergers, name changes, et cetera. The</p> <p>4 umbrella company, which is still a public</p> <p>5 company today, was called Acuity Brands. I</p> <p>6 worked for a subsidiary known as Zep</p> <p>7 Manufacturing.</p> <p>8 Q Z-E-P?</p> <p>9 A Z-E-P, yes.</p> <p>10 Q What did you do for them?</p> <p>11 A Again, this was my career prior</p> <p>12 to getting into the role I have now, which</p> <p>13 is basically supply chain stuff. So my first</p> <p>14 position was actually as a -- I don't</p> <p>15 remember the exact job title, but I managed</p> <p>16 a manufacturing facility called Enforcer</p> <p>17 Products which was a division of Zep, which</p> <p>18 was a division of Acuity. Subsequent to</p> <p>19 that, I had various positions, again, in</p> <p>20 operations and supply chain management. I</p> <p>21 was VP of operations for a period of time,</p> <p>22 VP of supply chain for a period of time.</p> <p>23 And the business, by the way, is basically</p> <p>24 chemical manufacturing and distribution,</p> <p>25 both industrial and retail.</p>

<p style="text-align: right;">Page 13</p> <p>1 Walczak</p> <p>2 Q Is that Zep's business?</p> <p>3 A Zep's business, correct.</p> <p>4 Q After Zep, what did you do?</p> <p>5 A After Zep and Acuity, that was</p> <p>6 the end of the line. At that point I</p> <p>7 transitioned into investment management.</p> <p>8 Q What caused that transition?</p> <p>9 A I likely was to take a down-size</p> <p>10 package when the company was down-sizing and</p> <p>11 decided that I would basically trade for my</p> <p>12 own account and earning a living that way.</p> <p>13 Q What had your experience been</p> <p>14 trading prior to that point?</p> <p>15 A I have traded options off and on</p> <p>16 since 1985 personally. In roughly 1995,</p> <p>17 while working for Brach's Candy, I was -- a</p> <p>18 part of my supply chain role included a</p> <p>19 purchasing department. Within the purchasing</p> <p>20 department were two traders who traded</p> <p>21 basically cocoa futures and corn futures to</p> <p>22 hedge the Brach's Candy Company, to hedge</p> <p>23 the candy company's input costs. So I</p> <p>24 supervised them and during that time was</p> <p>25 exposed to an understanding of commodity</p>	<p style="text-align: right;">Page 15</p> <p>1 Walczak</p> <p>2 some cocoa and I did a little bit of orange</p> <p>3 juice, the liquidity is not so good there,</p> <p>4 but I did do some orange juice futures.</p> <p>5 Q Inspired by Trading Places?</p> <p>6 When you were engaging in personal trading</p> <p>7 of equity options and the commodity options</p> <p>8 that you mentioned, how frequently were you</p> <p>9 doing that?</p> <p>10 A The equity options really was an</p> <p>11 off and on thing, meaning my recollection is</p> <p>12 I did, in the mid '80's, I traded for a</p> <p>13 couple of years, didn't do so well and</p> <p>14 stopped for a few years. And then started up</p> <p>15 again in the '90s and I would say throughout</p> <p>16 the '90's, the best of my recollection, I</p> <p>17 was at least reasonably activity, usually</p> <p>18 had a trading account that I was active in</p> <p>19 for most of that period of time.</p> <p>20 Q "Active" meaning trading every</p> <p>21 day, trading every week, every month?</p> <p>22 A I would say more on a kind of a</p> <p>23 weekly basis. It wasn't really something I</p> <p>24 did every day, but there weren't -- it was a</p> <p>25 fairly consistent continuous activity.</p>
<p style="text-align: right;">Page 14</p> <p>1 Walczak</p> <p>2 futures and options in that space.</p> <p>3 Q Can you explain your level of</p> <p>4 interaction with those traders?</p> <p>5 A So I was their direct</p> <p>6 supervisor -- well, in point of fact, there</p> <p>7 was a senior trader who was my direct report</p> <p>8 and the junior trader reported to him, but</p> <p>9 it was a small group, so I had interaction</p> <p>10 with both of them on a pretty regular basis.</p> <p>11 Q What was your personal</p> <p>12 experience in actual trading prior to going</p> <p>13 into the investment management business?</p> <p>14 A So my personal experience was,</p> <p>15 as I said, early on trading equity options,</p> <p>16 options on individual securities on and off.</p> <p>17 And then after I became somewhat familiar</p> <p>18 and experienced with the commodity space</p> <p>19 through my work responsibilities, I did do</p> <p>20 personal trading of certain commodity</p> <p>21 futures and options.</p> <p>22 Q What types of commodity futures</p> <p>23 and options?</p> <p>24 A Recollection was because I was</p> <p>25 experienced in the grains, I did trade corn,</p>	<p style="text-align: right;">Page 16</p> <p>1 Walczak</p> <p>2 Q When you were trading options</p> <p>3 for your personal account, were you using</p> <p>4 any options pricing models?</p> <p>5 A Back then early on in the '90s,</p> <p>6 I don't recall using any particular models</p> <p>7 then.</p> <p>8 Q What types of -- how did you</p> <p>9 decide what you wanted to buy or sell?</p> <p>10 A Yes, it was basically I was, you</p> <p>11 know, as I said, familiar from my work with</p> <p>12 the dynamics and the fundamentals and so</p> <p>13 forth in the two markets that my traders</p> <p>14 traded for business. So given the</p> <p>15 understanding of those markets, I took a --</p> <p>16 used futures and options to take, you know,</p> <p>17 kind of fundamentally based market positions</p> <p>18 and market biases.</p> <p>19 Q What does that mean,</p> <p>20 "fundamentally based"?</p> <p>21 A Well, in other words, so in</p> <p>22 grains or -- grains is probably the one that</p> <p>23 there may be more familiarity with, but you</p> <p>24 look at crop reports, you look at supply and</p> <p>25 demand statistics from the government, you</p>

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1 Walczak
2 can read some independent research and
3 formulate kind of a bias about should I be
4 long or short in the corn market, for
5 example.
6 Q Approximately what year did you
7 decide to go into the investment management
8 business?
9 A Well, it was a little bit of
10 a -- it really wasn't as direct a decision
11 as to say, well, I want to stop what I'm
12 doing and go into investment management, it
13 wasn't a black or white or off or on switch.
14 The progression went -- I wasn't especially
15 stimulated or happy in my supply chain role
16 after doing it for, I think, 22 years and so
17 I was looking for an alternate way to
18 generate income. So that was really my
19 primary goal. And as I entered, you know,
20 left the '90's and the beginning of the next
21 decade, in roughly the year 2000, I started
22 to become more active and started to sort of
23 refine what I was doing with markets and
24 gravitate over to the equity index options
25 trading. So I was able -- you know, went

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1 Walczak
2 through some periods of time of not doing
3 well, but at a point I felt as though I had
4 achieved enough skill to generate a fairly
5 consistent income for myself. So when I had
6 the opportunity as a result of the merger of
7 a couple of companies in, let's say, it was
8 2005, opportunities to take, you know, an
9 exit package gave me a little bit of extra
10 capital, a little income continuation and I
11 decided I would just trade for myself. At
12 the same time, I did at that time sub an
13 entity. So in the back of my mind, I
14 thought, well, at some point if I'm good at
15 this, I want to at least establish a track
16 record, so I set up a registered entity and,
17 you know, developed a track record. And
18 after trading for, I don't know, in that
19 entity -- I traded the entity for about a
20 year with proprietary capital and then took
21 on outside money.
22 Q What was the entity you created?
23 A It was Harbor Assets.
24 Q And that was approximately in
25 2005?

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1 Walczak
2 A Yes. I don't remember the exact
3 date when I incorporated Harbor Assets, but
4 I do know that we started trading in
5 December of 2005.
6 Q So you spent a year trading your
7 own capital essentially?
8 A Correct.
9 Q Under Harbor Assets?
10 A Correct.
11 Q And then what happened?
12 A So during that year, I became a
13 member of the NFA, registered with the CFTC,
14 had a disclosure document prepared and --
15 during that year, I had gotten some
16 inquiries just from friends and family,
17 actually. It actually was kind of an
18 interesting story that I liked to tell in
19 that people were very concerned that I
20 didn't have a real job and when I explained
21 to them I was able to earn income from
22 trading, that got attention from
23 brothers-in-law and family members and so on
24 and so forth. So they were, in fact, you
25 know, some of my first clients when I opened

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1 Walczak
2 the fund to, you know, outside of my
3 personal capital investment.
4 Q In that first year that you were
5 trading, just with your own money, what were
6 you trading?
7 A It was trading -- I had already
8 gravitated even prior to 2005 to doing
9 options on the S&P 500.
10 Q Is there a reason that you chose
11 options specifically as opposed to the
12 underlying securities themselves?
13 A Yes, I felt that I had a high
14 skill level with the math and the complexity
15 of options. And, you know, it's almost like
16 when you play a sport, you know, so I'm six
17 foot four, so I play basketball. I felt
18 like, you know, options are something that I
19 understood, it was something that I felt
20 comfortable with, which is not true for a
21 lot of folks because options can be fairly
22 complex in terms of how they are price
23 valued, how they behave, but I was very
24 comfortable in that world, so I gravitated
25 towards that market and toward options.

<p style="text-align: right;">Page 21</p> <p>1 Walczak</p> <p>2 Q And were you successful in that</p> <p>3 first year of Harbor Assets in trading your</p> <p>4 own portfolio?</p> <p>5 A Yes.</p> <p>6 Q Do you recall what your return</p> <p>7 was?</p> <p>8 A It was roughly 50 percent.</p> <p>9 MR. SHANK: To be clear, that</p> <p>10 year would have been pretty much</p> <p>11 calendar 2006 that you were trading</p> <p>12 your own money?</p> <p>13 THE WITNESS: Yes.</p> <p>14 MR. SHANK: So it was late 2006</p> <p>15 that you took on money from outside?</p> <p>16 THE WITNESS: Actually the 1st</p> <p>17 of January of 2007 was the first</p> <p>18 outside client.</p> <p>19 Q Had you at that point, when you</p> <p>20 first took on outside money, had you</p> <p>21 developed a particular strategy?</p> <p>22 A Yes. When I first took on</p> <p>23 outside money, it's very similar to what I</p> <p>24 use today in managing the fund, at least it</p> <p>25 was the basics and it actually evolved</p>	<p style="text-align: right;">Page 23</p> <p>1 Walczak</p> <p>2 greatest impact on changes in options</p> <p>3 pricing.</p> <p>4 Q What types of valuation</p> <p>5 techniques are you referring to?</p> <p>6 A Black-Scholes modeling and there</p> <p>7 are some derivative models, but they are not</p> <p>8 very different, so Black-Scholes options</p> <p>9 pricing modeling.</p> <p>10 Q Were you using a Black-Scholes</p> <p>11 type model to price options at that time?</p> <p>12 A I believe so. I don't remember</p> <p>13 exactly when I started using software, but</p> <p>14 I'm comfortable that I was using it at the</p> <p>15 time that I formed the entity.</p> <p>16 Q So when you refer to volatility</p> <p>17 trading, can you explain what you mean by</p> <p>18 that other than simply trading options?</p> <p>19 A Sure. Well, changes in</p> <p>20 volatility, what I was referring to before,</p> <p>21 is that changes in volatility have an</p> <p>22 exponential, not linear impact on options</p> <p>23 pricing. So first thing to know is that.</p> <p>24 Second thing is that volatility,</p> <p>25 particularly in the market I'm trading, in</p>
<p style="text-align: right;">Page 22</p> <p>1 Walczak</p> <p>2 pretty rapidly into something very close to</p> <p>3 what I do now. So it was initially a mix of</p> <p>4 premium selling and volatility trading and</p> <p>5 over time that mix has shifted a little bit</p> <p>6 more towards volatility trading than some of</p> <p>7 the more common premium collection, time</p> <p>8 decay elements of options trading.</p> <p>9 Q Sticking with that 2006 period</p> <p>10 or when you first were formulating this</p> <p>11 strategy, what do you mean by volatility</p> <p>12 trading?</p> <p>13 A So as I mentioned, I enjoy</p> <p>14 options. They are a puzzle, it's something</p> <p>15 that I feel like I understand. So I did a</p> <p>16 lot of digging, a lot of education, both</p> <p>17 from the standpoint of books, seminars,</p> <p>18 et cetera, into valuation techniques and how</p> <p>19 options behave. And then obviously had</p> <p>20 experience in the marketplace with</p> <p>21 identifying how they behaved and early on,</p> <p>22 both from an academic experience and from an</p> <p>23 experiential standpoint, I determined that</p> <p>24 really volatility is the most important</p> <p>25 component of an option's value and has the</p>	<p style="text-align: right;">Page 24</p> <p>1 Walczak</p> <p>2 equities, volatility and price have a very</p> <p>3 strong and dependable relationship to one</p> <p>4 another. Typically when markets go up,</p> <p>5 volatility comes out of options pricing and</p> <p>6 vice versa.</p> <p>7 Q When you say "comes out," you</p> <p>8 mean comes down?</p> <p>9 A Right, comes down. So what I did</p> <p>10 was establish certain patterns that I felt</p> <p>11 were repeatable and reliable in terms of how</p> <p>12 volatility behaved and how volatility</p> <p>13 behaved drives how the options behave. So I</p> <p>14 developed, you know, an understanding and</p> <p>15 techniques to use in different types of</p> <p>16 volatility environments. In other words,</p> <p>17 here's what works in a high volatile</p> <p>18 environment, here's what works in a low</p> <p>19 volatile environment, here's how to take</p> <p>20 advantage of expectations for a rise in</p> <p>21 volatility or a decline in volatility.</p> <p>22 Q What types of patterns are you</p> <p>23 referring to?</p> <p>24 A Well, patterns in terms of</p> <p>25 volatility. So if you study volatility, it's</p>

<p style="text-align: right;">Page 25</p> <p>1 Walczak</p> <p>2 very mean reverting, meaning if volatility</p> <p>3 spikes high, it typically can be relied on</p> <p>4 to come back to some mean, whatever that</p> <p>5 might be in recent history. And vice versa,</p> <p>6 when it's low, it's a little less reliable</p> <p>7 in terms of when it's going to go higher,</p> <p>8 but if it's low for a long period of time,</p> <p>9 you can at least put positions on that will</p> <p>10 benefit when it does rise. So volatility</p> <p>11 patterns in terms of how volatility behaves</p> <p>12 can be used in options positions to earn a</p> <p>13 return.</p> <p>14 MR. SHANK: When you say when</p> <p>15 volatility is low, what do you consider</p> <p>16 to be low?</p> <p>17 THE WITNESS: Well, that's a</p> <p>18 interesting question. It really depends</p> <p>19 on what sort of history you want to</p> <p>20 look at and what time frame you are</p> <p>21 trading on. So what's low in 2017 or</p> <p>22 probably a better example is what's</p> <p>23 high in 2017 was low in 2008, for</p> <p>24 example. So it's really something that</p> <p>25 I look at from a lot of different time</p>	<p style="text-align: right;">Page 27</p> <p>1 Walczak</p> <p>2 recognizing it at its low, triggers me</p> <p>3 to take on certain positions that are</p> <p>4 different than the ones I might take on</p> <p>5 when volatility is high.</p> <p>6 Q In drawing these conclusions you</p> <p>7 have about how volatility behaves, you are</p> <p>8 looking at past performance of volatility?</p> <p>9 A Yes.</p> <p>10 Q Are you looking at anything</p> <p>11 else?</p> <p>12 A Well, as I mentioned, there's</p> <p>13 educational materials on how options get</p> <p>14 priced and how options impact them, so I</p> <p>15 have certainly over time done research on</p> <p>16 how volatility behaves, but most of it is my</p> <p>17 own experience in the market.</p> <p>18 Q Going back to the early years of</p> <p>19 Harbor Financial, can you take us through</p> <p>20 the development and evolution of your</p> <p>21 strategy from 2007 onward?</p> <p>22 A Sure. So the strategy began</p> <p>23 around both volatility and time decay. So in</p> <p>24 typical option strategies or I shouldn't say</p> <p>25 typical, but common option strategies</p>
<p style="text-align: right;">Page 26</p> <p>1 Walczak</p> <p>2 frame perspectives.</p> <p>3 MR. SHANK: What would you</p> <p>4 consider to be low volatility in early</p> <p>5 2017?</p> <p>6 THE WITNESS: Early 2017 --</p> <p>7 well, low volatility is historically</p> <p>8 low, so low volatility in 2017 is under</p> <p>9 12 on the VIX, sorry.</p> <p>10 Q And the VIX is a metric of</p> <p>11 volatility, measuring 30-day volatility,</p> <p>12 correct?</p> <p>13 A Correct.</p> <p>14 MR. SHANK: And volatility was</p> <p>15 historically low -- on the low side in</p> <p>16 early 2017?</p> <p>17 THE WITNESS: Yes, very much so.</p> <p>18 MR. SHANK: Based on mean</p> <p>19 reversion, were you expecting that it</p> <p>20 would eventually rise then?</p> <p>21 THE WITNESS: Yes. As I</p> <p>22 mentioned, it's less reliable than when</p> <p>23 it's high, it comes down, but it</p> <p>24 certainly drives me in my trading to do</p> <p>25 different things. In other words,</p>	<p style="text-align: right;">Page 28</p> <p>1 Walczak</p> <p>2 involve options selling. In other words,</p> <p>3 profiting strictly through time decay</p> <p>4 because the passage of time tends to be very</p> <p>5 reliable. So a very common option technique</p> <p>6 is simply go out in some form and sell</p> <p>7 option premium and watch it decay and</p> <p>8 there's a lot of different techniques, a lot</p> <p>9 of different ways to do that. What I did</p> <p>10 initially was try to use --</p> <p>11 Q But it doesn't always decay,</p> <p>12 right?</p> <p>13 A Well --</p> <p>14 Q Let me rephrase the question.</p> <p>15 Time to expiry always decreases, but that</p> <p>16 doesn't necessarily mean that the value of</p> <p>17 the option you sold is going to decrease</p> <p>18 over time, correct?</p> <p>19 A I would say that's partially</p> <p>20 correct. For any given set of other options</p> <p>21 Greeks, the option will decay in value. So</p> <p>22 if you look at an option and you sold it for</p> <p>23 \$5 and a week goes by and it's worth \$6, you</p> <p>24 would say, well, jeez, time decay is not</p> <p>25 working. Well, that's not true, what has</p>

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1 Walczak
 2 happened is either price has moved or more
 3 likely volatility has moved that offsets the
 4 time decay. So time decay is always present
 5 in options.
 6 Q But it's not the only factor in
 7 determining the value of the option?
 8 A That is correct. And so to
 9 complete the answer to your original
 10 question, the most important factor is
 11 volatility. So I use techniques that, again,
 12 initially were more focused on premium
 13 collection with being mindful of volatility
 14 and have pretty rapidly and actually in
 15 early of 2007 shifted the focus away from
 16 premium collection per se, time decay is
 17 always present, so we pay attention to it
 18 and at some times it becomes very important,
 19 but focused my attention more primarily on
 20 volatility. And a big part of that was
 21 experiencing a large volatility shock, a
 22 relatively large volatility shock in '07.
 23 So now I had a real world dynamic that was
 24 added to my experience base and caused me to
 25 make some adjustments to what I was doing to

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1 Walczak
 2 focus more on the volatility attributes of
 3 options and options spreads than simple time
 4 decay.
 5 Q What happened in 2007?
 6 A So in 2007, there was an event,
 7 I don't recall what it was, I think it was
 8 something going on in the Asian markets.
 9 The S&P, for example, was in a very, very
 10 low volatile regime in early 2007, the VIX
 11 was somewhere in the ten neighborhood. So
 12 not quite as low as today or a couple of
 13 weeks ago in 2017, but low, very low. Again,
 14 there was a news event, something occurred
 15 in the Asian markets that rattled the U.S.
 16 equities markets. The S&P was down, I want
 17 to say, roughly three percent in a day.
 18 Volatility exploded. The VIX in a period of
 19 two or three days, if I recall correctly,
 20 went from ten to 17 or 18. So, again, this
 21 was an experience -- this caused a pretty
 22 large drawdown in the Harbor Assets account
 23 and also made -- caused me to make some
 24 adjustments in how I treated volatility in
 25 my positions.

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1 Walczak
 2 Q What had your position been at
 3 the time prior to that news event?
 4 A I had various credit spreads on
 5 in the market.
 6 Q What does that mean?
 7 A That means I had a combination
 8 of long and short options that I had, the
 9 net of putting those positions on generated
 10 a credit to my account.
 11 Q Are you saying that the price
 12 you paid for the options you bought was less
 13 than the income you generated from the price
 14 that you sold?
 15 A That's correct.
 16 Q But more specifically what were
 17 your positions at that time prior to the
 18 news event, immediately preceding the news
 19 event?
 20 A I honestly can't recall the
 21 specific positions. I do remember that there
 22 was a credit in the account and I do
 23 remember how they reacted to the volatility
 24 shock.
 25 Q Were your positions options on

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1 Walczak
 2 S&P futures?
 3 A Yes, they were.
 4 Q Exclusively?
 5 A Yes.
 6 Q And how did those -- why was it
 7 that those positions reacted so poorly to
 8 the market movement?
 9 A Well, because they were also net
 10 short volatility, they had a short
 11 volatility exposure, and in particular they
 12 had a short volatility exposure below the
 13 market. So --
 14 Q What does that mean, "short
 15 volatility exposure below the market"?
 16 A Meaning these were -- I had --
 17 again, I'm not certain of the exact nature
 18 of the position, but I did have put options
 19 long and short below the market and the net
 20 volatility exposure of those put options --
 21 I mean, each option has a well defined
 22 sensitivity to volatility that can be
 23 expressed, it's a Greek called vega. So I
 24 remember this because I did a lot of
 25 analysis after the fact that the net of

<p style="text-align: right;">Page 33</p> <p>1 Walczak</p> <p>2 those -- the sum of the vega positions both</p> <p>3 longs and shorts ended up being short vega</p> <p>4 or short volatility, meaning you would</p> <p>5 expect them, the position, to decline in</p> <p>6 value as volatility went higher.</p> <p>7 MR. SHANK: You said you did</p> <p>8 that analysis after the fact back in</p> <p>9 2007?</p> <p>10 THE WITNESS: Correct.</p> <p>11 MR. SHANK: Did you make it a</p> <p>12 practice to monitor vega of your</p> <p>13 portfolio?</p> <p>14 THE WITNESS: At that time, I</p> <p>15 did monitor it. Going forward I monitor</p> <p>16 it a lot more closely, but, yes, I did</p> <p>17 monitor the vega exposure.</p> <p>18 Q Going forward after the event in</p> <p>19 2007?</p> <p>20 A Correct.</p> <p>21 MR. SHANK: Did that event in</p> <p>22 2007 crystalize for you the importance</p> <p>23 of vega?</p> <p>24 THE WITNESS: Yes, exactly.</p> <p>25 MR. SHANK: How quickly did that</p>	<p style="text-align: right;">Page 35</p> <p>1 Walczak</p> <p>2 move itself was certainly a major,</p> <p>3 major shock.</p> <p>4 Q What is "sigma"?</p> <p>5 A Standard deviation.</p> <p>6 Q When you say that that's a four</p> <p>7 sigma, five sigma move, what exactly do you</p> <p>8 mean?</p> <p>9 A That means that based on</p> <p>10 volatility priced into options, you can</p> <p>11 determine -- so ten VIX means there is a</p> <p>12 certain level of volatility priced into the</p> <p>13 30 days options. You can figure it out for</p> <p>14 all different options. Once you know what</p> <p>15 volatility is priced in the options, you can</p> <p>16 calculate standard deviation moves. And on a</p> <p>17 normal distribution, which is at least a</p> <p>18 close approximation for how options and</p> <p>19 markets behave, you can say, look, one</p> <p>20 percent or a one sigma move will happen</p> <p>21 two-thirds of the time, a two sigma move</p> <p>22 will happen 95 percent of the time or five</p> <p>23 percent of the time, sorry, and three sigma</p> <p>24 one percent of the time. So when you talk</p> <p>25 about moves greater than three sigma, that</p>
<p style="text-align: right;">Page 34</p> <p>1 Walczak</p> <p>2 spike from ten to 17 or 18 happen?</p> <p>3 THE WITNESS: There was a</p> <p>4 single-day event, there were a few</p> <p>5 aftershocks. Again, I'm just going from</p> <p>6 memory, but my best recollection is</p> <p>7 that it was about a three-day period</p> <p>8 where the VIX rose pretty rapidly and</p> <p>9 then peaked.</p> <p>10 MR. SHANK: Was this event</p> <p>11 something catastrophic or was it sort</p> <p>12 of a normal market disruption?</p> <p>13 THE WITNESS: Well, it depends,</p> <p>14 I guess, on how you define that. I</p> <p>15 don't recall. It wasn't an act of war,</p> <p>16 it wasn't a natural disaster. Again, it</p> <p>17 was something that disrupted equity. I</p> <p>18 do remember -- well, my best</p> <p>19 recollection is that the market was</p> <p>20 down roughly three percent on that day</p> <p>21 with a ten VIX. So that, if you do the</p> <p>22 math on that, that's a, you know,</p> <p>23 that's a four sigma, five sigma kind of</p> <p>24 move. So the move, what precipitated</p> <p>25 that, again, I don't remember, but the</p>	<p style="text-align: right;">Page 36</p> <p>1 Walczak</p> <p>2 means they have a very tiny, less than one</p> <p>3 percent chance theoretically of occurring.</p> <p>4 Q When you are talking about</p> <p>5 theoretical likelihood of occurring, that's</p> <p>6 based on past market performance, correct?</p> <p>7 A It is and that's an important</p> <p>8 distinction because the first thing that</p> <p>9 happens is you'll get people saying, look,</p> <p>10 there is a ten VIX, this is a four sigma,</p> <p>11 five sigma move. On the other hand, three</p> <p>12 days later, the VIX is at 18. Now, if you</p> <p>13 plug in 18, it's no longer a four sigma</p> <p>14 move. So it becomes, you know, what's the</p> <p>15 right sigma to use and that's always -- and</p> <p>16 so you can use historical realized</p> <p>17 volatility in the market and then you say do</p> <p>18 I use 30 day volatility, do I use the last</p> <p>19 year, so it's all over the map. But the</p> <p>20 importance of the VIX is the VIX reflects</p> <p>21 what actual market participants are pricing</p> <p>22 into options. So the marketplace believes</p> <p>23 that the right sigma to use is based on a</p> <p>24 ten VIX, for example.</p> <p>25 Q In the 2007 drawdown that you</p>

<p style="text-align: right;">Page 37</p> <p>1 Walczak</p> <p>2 referred to earlier, what was the magnitude</p> <p>3 of that for Harbor Assets?</p> <p>4 A Peak to valley, I don't remember</p> <p>5 exactly, so I can't quote you exact numbers.</p> <p>6 It was greater than 20 percent.</p> <p>7 Q What was the size of the fund at</p> <p>8 that time?</p> <p>9 A I don't remember that number</p> <p>10 either.</p> <p>11 Q Can you approximate before and</p> <p>12 after that 20-plus percent move?</p> <p>13 A Well, it was certainly less than</p> <p>14 \$2 million.</p> <p>15 Q Before?</p> <p>16 A And after.</p> <p>17 Q Well, right, obviously, but and</p> <p>18 at that time of the 20-plus percent</p> <p>19 drawdown, had you taken on outside money?</p> <p>20 A Yes.</p> <p>21 Q What happened after the drawdown</p> <p>22 in 2007?</p> <p>23 A Could you be more specific?</p> <p>24 Q Before you mentioned that you</p> <p>25 looked at things differently after the</p>	<p style="text-align: right;">Page 39</p> <p>1 Walczak</p> <p>2 some modifications to the types of options</p> <p>3 spreads that I use and set in place a risk</p> <p>4 framework that really, you know, wasn't</p> <p>5 formally in place prior.</p> <p>6 Q So you mentioned two pieces</p> <p>7 there, let's start with the first. What</p> <p>8 modifications did you make to the options</p> <p>9 spreads you were using?</p> <p>10 A So the first thing I determined</p> <p>11 was that this decline had caused a severe</p> <p>12 adverse reaction in my positions. So I</p> <p>13 further broke that down and said why was</p> <p>14 that. And, for example, it wasn't the delta,</p> <p>15 I looked and said, obviously it's not theta,</p> <p>16 it happened in a day, so time decay is not</p> <p>17 hurting me. Is it the price movement, pretty</p> <p>18 significant price movement? But I used the</p> <p>19 model I was using at the time and said well,</p> <p>20 price movement was probably a relatively</p> <p>21 minor part of this.</p> <p>22 Q That three percent S&P drop?</p> <p>23 A Exactly.</p> <p>24 Q Was relatively a minor part of</p> <p>25 what?</p>
<p style="text-align: right;">Page 38</p> <p>1 Walczak</p> <p>2 drawdown, you reevaluated things, how did</p> <p>3 you do that?</p> <p>4 A All right. So common practice, I</p> <p>5 think, for most traders or managers, if you</p> <p>6 have a drawdown, you have to look and say</p> <p>7 what caused this, is there something I need</p> <p>8 to change about what I'm doing, is this</p> <p>9 simply a normal noise in my trading results.</p> <p>10 So to me that's a normal reaction, that was</p> <p>11 my reaction, to look and say, look, we had a</p> <p>12 drawdown does something need to be done.</p> <p>13 Now, pretty quickly, you say this is a big</p> <p>14 enough drawdown that it's probably not</p> <p>15 noise. So a couple of things. I looked at,</p> <p>16 first and foremost, risk management and said</p> <p>17 at this point what happened, how do I</p> <p>18 prevent this from happening again just from</p> <p>19 a pure risk standpoint. And then also, even</p> <p>20 if I put risk metrics in place, how can I</p> <p>21 modify some of the techniques I'm using in</p> <p>22 terms of what option spreads I'm using to do</p> <p>23 a better job of preventing this from</p> <p>24 happening even independent of a risk</p> <p>25 trigger. So I did all those things and made</p>	<p style="text-align: right;">Page 40</p> <p>1 Walczak</p> <p>2 A Of the overall drawdown</p> <p>3 producing event. In other words, when I</p> <p>4 looked at my position and it went under</p> <p>5 water by 20 percent, when I looked at it, I</p> <p>6 said, well, the delta may be, you know,</p> <p>7 maybe that's a third of it or maybe even</p> <p>8 less.</p> <p>9 Q For the record, what is delta?</p> <p>10 A Delta is how you expect an</p> <p>11 options price to behave based on price</p> <p>12 movement of the underlying security,</p> <p>13 whatever the option is optionable on.</p> <p>14 Q In your case, the underlying</p> <p>15 security is always S&P?</p> <p>16 A S&P 500, yes.</p> <p>17 Q So delta as applied to your</p> <p>18 portfolio at the time would measure how your</p> <p>19 portfolio would move given an X percent move</p> <p>20 in the S&P?</p> <p>21 A That's correct, other than only</p> <p>22 that I didn't. In this case, all I did was</p> <p>23 look at the particular positions that got</p> <p>24 hurt in this and after the fact. In other</p> <p>25 words, I didn't come into it looking at</p>

<p style="text-align: right;">Page 41</p> <p>1 Walczak</p> <p>2 delta these options, this was kind of a post</p> <p>3 drawdown analysis. I said all right, what</p> <p>4 hurt me, did delta, did vega, did theta.</p> <p>5 You know, theta, like I said, it's obviously</p> <p>6 not theta. So that's where I looked and</p> <p>7 said, well, the delta of this position</p> <p>8 coming into this crash, if I apply the</p> <p>9 market move against that delta, I shouldn't</p> <p>10 have been hurting or near this bad. Then</p> <p>11 when I applied the vega, I said okay, it's</p> <p>12 vega, it's volatility.</p> <p>13 Q So what do you do --</p> <p>14 MR. SHANK: Sorry.</p> <p>15 MR. WASSERMAN: Go ahead.</p> <p>16 MR. SHANK: But delta is always</p> <p>17 changing, though, correct?</p> <p>18 THE WITNESS: Yes, delta is</p> <p>19 always changing.</p> <p>20 MR. SHANK: So even accounting</p> <p>21 for the fact that delta is changing,</p> <p>22 you are saying that delta wasn't the</p> <p>23 primary effect on your portfolio?</p> <p>24 THE WITNESS: That was my</p> <p>25 conclusion at the time, yes.</p>	<p style="text-align: right;">Page 43</p> <p>1 Walczak</p> <p>2 scenario, you would expect the portfolio to</p> <p>3 move three times as much as the market in</p> <p>4 the opposite direction?</p> <p>5 A Correct. And two points that are</p> <p>6 relevant to that is, one, is delta always</p> <p>7 changes and, second, back to my learning</p> <p>8 from 2007, is volatility is very important</p> <p>9 in that -- and in my experience, volatility</p> <p>10 was far more important than delta.</p> <p>11 MR. SHANK: So you defined delta</p> <p>12 for us. Can you define vega as well?</p> <p>13 THE WITNESS: Sure. Vega, and,</p> <p>14 again, it depends on what kind of unit</p> <p>15 of measure you want to use and so it's</p> <p>16 a little less clean, but vega means for</p> <p>17 a point of volatility movement, you</p> <p>18 would expect, if your vega is two, you</p> <p>19 would expect a two point move in the</p> <p>20 underlying option.</p> <p>21 MR. SHANK: So using your</p> <p>22 example where volatility jumped from</p> <p>23 ten to 17, if your vega was two, what</p> <p>24 would you expect to happen to your</p> <p>25 portfolio?</p>
<p style="text-align: right;">Page 42</p> <p>1 Walczak</p> <p>2 MR. SHANK: And just so we are</p> <p>3 on the same page, what would a delta of</p> <p>4 negative point five mean?</p> <p>5 THE WITNESS: That means that</p> <p>6 you would expect the option to move, if</p> <p>7 the market moves ten points, you would</p> <p>8 expect the option to move five.</p> <p>9 MR. SHANK: The delta, say,</p> <p>10 negative three?</p> <p>11 THE WITNESS: If the market</p> <p>12 moves five points, you would expect the</p> <p>13 option to move 15 points.</p> <p>14 MR. SHANK: Just --</p> <p>15 Q Just to clarify that, I believe</p> <p>16 the question was if the delta was negative</p> <p>17 five --</p> <p>18 MR. SHANK: Negative three.</p> <p>19 Q I'm sorry, negative three. In a</p> <p>20 negative delta scenario, are you expecting</p> <p>21 your portfolio to move in the same direction</p> <p>22 of the market or in the opposite direction</p> <p>23 of the market?</p> <p>24 A The opposite direction.</p> <p>25 Q In a negative three delta</p>	<p style="text-align: right;">Page 44</p> <p>1 Walczak</p> <p>2 THE WITNESS: Again, I'm not</p> <p>3 able to really clarify as you asked me</p> <p>4 that, you know, because I used a model</p> <p>5 and plugged it in, so it's difficult</p> <p>6 for me to say -- to get my units of</p> <p>7 measure correct, to be honest. So --</p> <p>8 MR. SHANK: But vega is</p> <p>9 measuring amount of percentage point</p> <p>10 moves in your portfolio relative to</p> <p>11 each point change in volatility?</p> <p>12 THE WITNESS: Yes, I mean that's</p> <p>13 what vega is measuring. So if I'm</p> <p>14 looking at my modeling software, using</p> <p>15 the VIX as an example, now the VIX is</p> <p>16 an index, but every option has a</p> <p>17 certain number in there that</p> <p>18 corresponds to its volatility, so if I</p> <p>19 plug in plus five for a particular</p> <p>20 option, the software will tell me what</p> <p>21 happens to that option.</p> <p>22 Q If you plug in plus five what?</p> <p>23 A Again, it's a unit to measure</p> <p>24 things. So volatility is often expressed in</p> <p>25 percentages and I don't want to get --</p>

<p style="text-align: right;">Page 45</p> <p>1 Walczak</p> <p>2 Q I'm just trying to make sure we</p> <p>3 are clear. When you say plug in plus five,</p> <p>4 what is the plus five, plus five vega, plus</p> <p>5 five delta?</p> <p>6 A It's a plus five vega, right.</p> <p>7 Again, I apologize but I'm not able</p> <p>8 coherently, I guess, to express what units.</p> <p>9 Delta is very easy to express in units. It's</p> <p>10 simply a decimal. Vega has a percentage</p> <p>11 number. So if vega is up, you know, five and</p> <p>12 volatility goes up by five, I don't want to</p> <p>13 say an option change in value by 25 because</p> <p>14 I'm not sure we are talking apples to</p> <p>15 apples.</p> <p>16 Q You mentioned that you use a</p> <p>17 program. Were you using a program in 2007?</p> <p>18 A Yes.</p> <p>19 Q What program were you using?</p> <p>20 A I would have to go back and</p> <p>21 check my records. I think it would have been</p> <p>22 Option View. I have been using Option View</p> <p>23 for a very long time, but I haven't always</p> <p>24 used Option View, so I would have to go back</p> <p>25 and check. I can't tell you exactly which</p>	<p style="text-align: right;">Page 47</p> <p>1 Walczak</p> <p>2 MR. SHANK: Put aside sigma for</p> <p>3 a second, but say you have a half</p> <p>4 percent type of event, how frequently</p> <p>5 would you expect that to happen in the</p> <p>6 marketplace?</p> <p>7 THE WITNESS: I really don't</p> <p>8 know. I don't really have any basis to</p> <p>9 figure that out.</p> <p>10 MR. WASSERMAN: Half percent S&P</p> <p>11 move, half percent VIX move?</p> <p>12 MR. SHANK: No, a half percent</p> <p>13 move based on a standard deviation</p> <p>14 probability event. So there are about</p> <p>15 252 trading days in a year, correct?</p> <p>16 THE WITNESS: 250, 256,</p> <p>17 something like that.</p> <p>18 MR. SHANK: Give or take, right?</p> <p>19 THE WITNESS: Right.</p> <p>20 MR. SHANK: So a half percent</p> <p>21 event, would you expect that to happen</p> <p>22 more frequently than annually?</p> <p>23 THE WITNESS: Again, statistics</p> <p>24 isn't really linear, so, you know,</p> <p>25 it's -- when you talk about sigma, you</p>
<p style="text-align: right;">Page 46</p> <p>1 Walczak</p> <p>2 one, but I was using an option pricing</p> <p>3 software.</p> <p>4 Q In 2007 when you were doing your</p> <p>5 postmortem on what happened to the portfolio</p> <p>6 and measuring things like delta and vega to</p> <p>7 evaluate the cause of the drawdown, were you</p> <p>8 calculating delta and vega on individual</p> <p>9 options or on the portfolio as a whole?</p> <p>10 A Individual options in that case.</p> <p>11 MR. SHANK: Did you ever take a</p> <p>12 look at the portfolio as a whole?</p> <p>13 Q At that time.</p> <p>14 A At that time, I don't recall</p> <p>15 doing it, no.</p> <p>16 MR. SHANK: Can I follow-up on</p> <p>17 one thing you said about a four sigma</p> <p>18 event and you said something less than</p> <p>19 one percent? How frequently would you</p> <p>20 expect, say, a half percent event to</p> <p>21 occur in the market?</p> <p>22 THE WITNESS: I can look that up</p> <p>23 in a stats book, but I don't know off</p> <p>24 the top of my head what sort of sigma</p> <p>25 corresponds to a half percent.</p>	<p style="text-align: right;">Page 48</p> <p>1 Walczak</p> <p>2 should talk about bell curve, it's not</p> <p>3 linear. You got to look it up in the</p> <p>4 book and say all right -- I happen to</p> <p>5 know off the top of my head that</p> <p>6 roughly a one percent thing is three</p> <p>7 sigma just from memory, but if you go</p> <p>8 to a half percent, it's not automatic</p> <p>9 to be able to determine what that is. I</p> <p>10 would go look it up if I needed to know</p> <p>11 that.</p> <p>12 MR. SHANK: I'm not worried</p> <p>13 about what sigma that relates to. I'm</p> <p>14 just saying, if you have an event that</p> <p>15 happens about a half percent of the</p> <p>16 time, that would be about once every</p> <p>17 200 trading days?</p> <p>18 THE WITNESS: All right, so you</p> <p>19 are telling me there is an event that</p> <p>20 happens once in 200 occurrences, right?</p> <p>21 MR. SHANK: Which would be a</p> <p>22 half percent, right?</p> <p>23 THE WITNESS: That's what I</p> <p>24 mean. Just to clarify, yes.</p> <p>25 MR. SHANK: You would expect</p>

<p style="text-align: right;">Page 49</p> <p>1 Walczak</p> <p>2 that to happen more frequently than</p> <p>3 annually, correct?</p> <p>4 THE WITNESS: Again, I don't</p> <p>5 want to try to become a statistics</p> <p>6 professor, because I'm not, but stats</p> <p>7 and probabilities don't work that way.</p> <p>8 On average over a long period of time,</p> <p>9 you can look back and say, wow, this</p> <p>10 thing happened once every 200</p> <p>11 occurrences, but it can be extremely</p> <p>12 irregular. It can go, you know, 500</p> <p>13 times without happening and then happen</p> <p>14 twice in a hundred occurrences and over</p> <p>15 time you say that's a half percent.</p> <p>16 MR. SHANK: Fair enough. But on</p> <p>17 average, you would expect that to</p> <p>18 happen about every 200 trading days?</p> <p>19 THE WITNESS: You know, I'm</p> <p>20 certainly not trying to be wonky about</p> <p>21 this, but it's an important point,</p> <p>22 things are not regular in statistical</p> <p>23 distribution. So I would say that's an</p> <p>24 occasion where you say on average it</p> <p>25 happens every 200 occurrences and now</p>	<p style="text-align: right;">Page 51</p> <p>1 Walczak</p> <p>2 principal learning from this drawdown was</p> <p>3 that I had to incorporate even more</p> <p>4 volatility analytics in what I was doing.</p> <p>5 And what I mean by that is, in my postmortem</p> <p>6 I discovered that the primary cause -- the</p> <p>7 primary cause of the impact, the great</p> <p>8 impact on positions below the market was</p> <p>9 volatility. Secondary causes were the number</p> <p>10 of positions I had on. So I made -- and</p> <p>11 really encapsulating that is the issue of</p> <p>12 not having a formal risk management</p> <p>13 structure in place. So two things going</p> <p>14 forward. Primarily, I took volatility</p> <p>15 characteristics of my positions and set some</p> <p>16 stricter guidelines about when, where, how</p> <p>17 to put on positions with respect to</p> <p>18 volatility. For example, I learned that the</p> <p>19 positions I had below the market, underneath</p> <p>20 the market put positions, were net short</p> <p>21 volatility and that was a major cause, I</p> <p>22 generally understood that going in, I didn't</p> <p>23 fully understand the magnitude of the impact</p> <p>24 of a sudden rare volatility event. So going</p> <p>25 forward, I did -- I cut -- I set risk</p>
<p style="text-align: right;">Page 50</p> <p>1 Walczak</p> <p>2 we have gone 400 occurrences without</p> <p>3 happening, now I think maybe it's more</p> <p>4 likely that it's about to happen. But</p> <p>5 in the meantime, it's almost like, you</p> <p>6 know, I don't know if it's going to</p> <p>7 happen because an average -- you have</p> <p>8 to look at statistics because an</p> <p>9 average can be, like I mentioned, you</p> <p>10 can look and see it's distributed where</p> <p>11 you go 500 times without it happening</p> <p>12 and then you have three occurrences and</p> <p>13 then you look back and say there is an</p> <p>14 average. I wouldn't draw any conclusion</p> <p>15 from something like that.</p> <p>16 MR. SHANK: Okay.</p> <p>17 BY MR. WASSERMAN:</p> <p>18 Q Mr. Walczak, can you further</p> <p>19 explain how you changed your trading</p> <p>20 strategy after your 2007 drawdown?</p> <p>21 A Sure. What have I told you</p> <p>22 already?</p> <p>23 Q Actually, what was your trading</p> <p>24 strategy after the 2007 drawdown?</p> <p>25 A Sure. So as I mentioned, the</p>	<p style="text-align: right;">Page 52</p> <p>1 Walczak</p> <p>2 parameters in place and at the same time</p> <p>3 modified positions so that when I put on</p> <p>4 positions below the market, they would be at</p> <p>5 least neutral to volatility and ideally</p> <p>6 positive, but at least neutral. And then I</p> <p>7 also looked at positions above the market</p> <p>8 and discovered I had short exposure above</p> <p>9 the market as well, however, there was no</p> <p>10 need to modify those positions because of</p> <p>11 the inverse relationship between volatility</p> <p>12 and price. I could expect volatility to</p> <p>13 decline if the market rose, therefore, it</p> <p>14 didn't present an additional risk to my</p> <p>15 positions on the top of the market. So those</p> <p>16 positions were okay from that standpoint.</p> <p>17 Q What was the strategy?</p> <p>18 A So the strategy in 2007 was</p> <p>19 focused on premium collection with a</p> <p>20 secondary consideration of volatility. And</p> <p>21 coming out of 2007 it really became focused</p> <p>22 on volatility, premium collection was put</p> <p>23 aside. Premium collection is really another</p> <p>24 way to account for theta. So --</p> <p>25 Q When you say the strategy was</p>

<p style="text-align: right;">Page 53</p> <p>1 Walczak</p> <p>2 focused on volatility, what does that mean</p> <p>3 in terms of what you are buying and selling?</p> <p>4 A All right. So it's a complex</p> <p>5 subject, so let me try to figure out where</p> <p>6 to start. So in periods of low volatility,</p> <p>7 the risk and the opportunities of volatility</p> <p>8 increases and vice versa in periods of high</p> <p>9 volatility. So I was always buying and</p> <p>10 selling options and trying to put together</p> <p>11 spreads that took advantage of those</p> <p>12 relationships. And that means that I can use</p> <p>13 a combination of long and short put options</p> <p>14 below the market that have at least a</p> <p>15 neutral exposure to volatility and over time</p> <p>16 that neutral exposure, as the longs and</p> <p>17 shorts move through time, becomes a long</p> <p>18 exposure to volatility. So that's an example</p> <p>19 of how I focused my positions on volatility.</p> <p>20 MR. SHANK: How did you go about</p> <p>21 measuring whether you were neutral or</p> <p>22 positive volatility?</p> <p>23 THE WITNESS: Again, then I</p> <p>24 would use my software on a particular</p> <p>25 motion to determine what the volatility</p>	<p style="text-align: right;">Page 55</p> <p>1 Walczak</p> <p>2 do, again, a simple sell one buy one or a</p> <p>3 buy one sell two or a buy one sell three.</p> <p>4 Again, it depended on the analysis of</p> <p>5 volatility in that moment.</p> <p>6 Q How did it depend on the</p> <p>7 analysis of volatility in that moment?</p> <p>8 A Well, it depended on -- you can</p> <p>9 look at, in a particular expiration month,</p> <p>10 what is the volatility in that expiration</p> <p>11 month at the money and then you could look</p> <p>12 at individual options and determine what</p> <p>13 their volatility -- what volatility is built</p> <p>14 into them as well, which is different.</p> <p>15 Q How are those two things</p> <p>16 different?</p> <p>17 A Well, the volatility of at the</p> <p>18 money options, again, the VIX, for example,</p> <p>19 is an index and it's a calculation to</p> <p>20 approximate the volatility of an at the</p> <p>21 money S&P 500 option with 30 days to go. If</p> <p>22 you look at any individual option, the</p> <p>23 Black-Scholes model will tell up, based on</p> <p>24 the market price, will back you into what</p> <p>25 volatility is built into that option. So --</p>
<p style="text-align: right;">Page 54</p> <p>1 Walczak</p> <p>2 exposure was.</p> <p>3 Q What specifically would you look</p> <p>4 at?</p> <p>5 A I would look at the sum of the</p> <p>6 vegas on all the different parts of the legs</p> <p>7 in the position and determine whether it was</p> <p>8 positive or negative.</p> <p>9 Q What other aspects of your</p> <p>10 strategy were there?</p> <p>11 A So the other aspect is sort of</p> <p>12 the contra aspect of it, meaning neutral to</p> <p>13 volatility below the market, short</p> <p>14 volatility above the market. So above the</p> <p>15 market I wanted to put on positions, again,</p> <p>16 that were short volatility and had the</p> <p>17 opportunity to profit as volatility</p> <p>18 declined.</p> <p>19 Q What specifically did that</p> <p>20 entail?</p> <p>21 A An example of a position?</p> <p>22 Q Yes.</p> <p>23 A So above the market we -- the</p> <p>24 same positions that I'm using today, for</p> <p>25 example, could do really two things, could</p>	<p style="text-align: right;">Page 56</p> <p>1 Walczak</p> <p>2 Q Just with the first piece you</p> <p>3 mentioned about the VIX telling you the</p> <p>4 volatility of options 30 days out, am I</p> <p>5 articulating that correctly?</p> <p>6 A Correct. At the money is an</p> <p>7 important part of this.</p> <p>8 Q At the money options 30 days</p> <p>9 out?</p> <p>10 A Right.</p> <p>11 Q That's an aggregate measurement,</p> <p>12 correct?</p> <p>13 A I believe so.</p> <p>14 Q And it's giving you the implied</p> <p>15 volatility of, in aggregate, of the market</p> <p>16 for at the money options 30 days out?</p> <p>17 A Again, I don't know the exact</p> <p>18 calculations, but that's what it's meant to</p> <p>19 represent.</p> <p>20 Q The second piece, the difference</p> <p>21 with the second piece is that there is</p> <p>22 implied volatility -- there is volatility</p> <p>23 implied in the pricing of individual</p> <p>24 options, correct?</p> <p>25 A Correct.</p>

<p style="text-align: right;">Page 57</p> <p>1 Walczak</p> <p>2 Q So given those two pieces that</p> <p>3 you've described, how do you implement your</p> <p>4 strategy?</p> <p>5 A So a couple of things. We look</p> <p>6 at something called the term structure of</p> <p>7 volatility and that means that we just</p> <p>8 talked about the VIX being at 30 days to</p> <p>9 expiration, you can get an aggregate number</p> <p>10 for options with 60 days to expiration and</p> <p>11 with 90 days to expiration. And you can also</p> <p>12 look at the VIX futures curve as well for</p> <p>13 kind of a shorthand of what volatility</p> <p>14 built into -- what assumptions or what the</p> <p>15 actual pricing on VIX futures is going out.</p> <p>16 So at any rate, the term structure of</p> <p>17 volatility functions very much like a yield</p> <p>18 curve in fixed income. You look at different</p> <p>19 durations of fixed income securities, they</p> <p>20 have different yields and how those things</p> <p>21 change is important to a fixed income</p> <p>22 manager in terms of how he structures a</p> <p>23 portfolio. So I look at the equivalent</p> <p>24 options curve, meaning the VIX is at ten,</p> <p>25 the 60 day version of the VIX might be at 11</p>	<p style="text-align: right;">Page 59</p> <p>1 Walczak</p> <p>2 there's real world considerations, too. I</p> <p>3 might want to trade a particular month where</p> <p>4 there is, you know, theoretically there is</p> <p>5 volatility out there according to the VIX</p> <p>6 futures, but options don't trade or CME</p> <p>7 options don't trade that month, but at any</p> <p>8 rate, I look and find the highest level of</p> <p>9 volatility that I can trade to put on my</p> <p>10 spreads and I use that curve to tell me</p> <p>11 where that is.</p> <p>12 Q So the options that have a</p> <p>13 higher implied volatility are generally more</p> <p>14 expensive, correct?</p> <p>15 A Yes.</p> <p>16 Q All other things being equal</p> <p>17 A Yes, it's kind of the other way</p> <p>18 around -- no, you are right, options with</p> <p>19 higher implied volatility are expensive,</p> <p>20 more expensive, correct.</p> <p>21 Q So why are you looking at that</p> <p>22 exclusively?</p> <p>23 A Well, it's not exclusive, it's a</p> <p>24 fundamental part of what we do. In fact,</p> <p>25 it's the building block, the first place we</p>
<p style="text-align: right;">Page 58</p> <p>1 Walczak</p> <p>2 or it might also be at ten. The 90 day VIX,</p> <p>3 same thing. So you can plot that curve and</p> <p>4 that's instructive to me in terms of what</p> <p>5 type of option spreads to put on, how I</p> <p>6 expect them to behave and, in fact, where to</p> <p>7 put them on.</p> <p>8 Q How is that instructive to you</p> <p>9 and how exactly does it help you determine</p> <p>10 where to put positions on?</p> <p>11 A Sure. So in most options</p> <p>12 strategies, the one I use is part of this,</p> <p>13 more volatility is better. Meaning more</p> <p>14 volatility means higher options pricing,</p> <p>15 that allows me within my strategy to</p> <p>16 construct more favorable options spreads.</p> <p>17 And so if I see that the VIX is at ten and</p> <p>18 the 120 day version of the VIX is at 13,</p> <p>19 which is -- that's actually typical numbers</p> <p>20 when the VIX is at ten, then I automatically</p> <p>21 want to be in the 13 side of things because</p> <p>22 there is more volatility. There are also</p> <p>23 some other advantages, but I'm looking for</p> <p>24 volatility along that curve and when I see</p> <p>25 that I get a high enough volatility -- and</p>	<p style="text-align: right;">Page 60</p> <p>1 Walczak</p> <p>2 start because when options are more</p> <p>3 expensive, then you can construct spreads --</p> <p>4 I've found that you can construct option</p> <p>5 spreads that have a better probability of</p> <p>6 making money.</p> <p>7 Q So I apologize, I'm trying to</p> <p>8 get some concrete examples of the strategy.</p> <p>9 What exactly is the strategy that you are</p> <p>10 implementing following your 2007 drawdown,</p> <p>11 what exactly are you buying and selling,</p> <p>12 where are you buying and selling it and</p> <p>13 what -- let's start with that?</p> <p>14 A Good. So now I understand the</p> <p>15 question. So two things, when the volatility</p> <p>16 curve -- I'll describe the strategy as I do</p> <p>17 when people ask the nuts and bolts behind</p> <p>18 it. So I mentioned that we have this</p> <p>19 volatility curve and we like higher</p> <p>20 volatility, the strategy above the market is</p> <p>21 to buy a call option and sell multiple other</p> <p>22 call options usually at or near the same net</p> <p>23 premium. Meaning as I mentioned, we don't</p> <p>24 collect premium as a means of earning a</p> <p>25 return, we will collect it if we have long</p>

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1 Walczak
 2 premium in a portfolio and we want to offset
 3 in new positions that we are adding, but
 4 generally we are not out trying to collect
 5 net option premium. We do from time to time.
 6 Like I said, there are circumstances that we
 7 do. So we will buy a long call option above
 8 the market, we will sell two or three. In
 9 recent years, we have done some research, we
 10 used to do one by two, now we do one by
 11 three, same concept, though, and the concept
 12 is we don't want to just go out and buy
 13 options because they decline with time. So
 14 you buy options, nothing happens in the
 15 marketplace, you are going to lose money
 16 slowly over time. So what we do is we buy an
 17 option, we sell options further away from
 18 the market using a ratio of one to two or in
 19 recent years one to three, again, based on
 20 some research that we have done. And the net
 21 of it is we don't spend capital on that
 22 position. If the market goes sideways, we
 23 can actually make some money because that
 24 position is short volatility and it will
 25 come down that curve. So we are out in a

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1 Walczak
 2 region where the volatility is 13, for
 3 example, and over the life of that position
 4 it comes to, you know, near to expiration
 5 and the VIX is now ten, so the 13 comes down
 6 to ten. It's a short volatility position, we
 7 can make money that way. Even if that
 8 doesn't happen, the only way it doesn't
 9 happen is if the VIX spikes in the meantime.
 10 If it doesn't happen and the market is flat,
 11 typically those short options will decay a
 12 little bit faster than the long options, so
 13 something we didn't invest any money in, we
 14 can sell. So we can come in at even and then
 15 we sell it as it approaches expiration for
 16 \$2, \$5 or something like that and make some
 17 money that way. And that's another factor in
 18 terms of looking for that higher volatility
 19 because we want it to drain down over time.
 20 Thirdly, if the market actually starts to
 21 advance towards our position, we can get to
 22 a place where the long option is worth a
 23 significant amount of money and the short
 24 options are still away from the market and
 25 declined in value or end up worthless.

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1 Walczak
 2 Q What are the risks to this
 3 strategy?
 4 A There is another part of the
 5 strategy if you want to hear, but I can talk
 6 through the risks on this one as well.
 7 Q Yes. What are the risks of this
 8 particular strategy?
 9 A The risk to this strategy is
 10 that the market advances rapidly enough that
 11 the short options increase in value faster
 12 than the long option does.
 13 Q What are the limits to that
 14 risk?
 15 A Initially when we put the
 16 position on, the risks are theoretically
 17 unlimited to the up side.
 18 Q Is the other strategy you were
 19 just referring to, the put strategy that you
 20 explained earlier?
 21 A Yes. I don't recall really
 22 explaining it very well, but it is a put
 23 strategy.
 24 Q Why don't you briefly explain
 25 it.

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1 Walczak
 2 A Sure. So below the market we use
 3 a different structure. Above the market all
 4 our -- the legs of our position are in the
 5 same expiration month. Below the market we
 6 trade calendar spreads so that the different
 7 legs of the position are in different
 8 expiration months. And we do that because it
 9 allows us to give -- to achieve a volatility
 10 exposure with these options below the
 11 market. And that is typically our goal, to
 12 put on options below the market at least at
 13 a neutral volatility level and then over
 14 time we know they became long volatility, we
 15 can add to positions, we can take back legs
 16 on the position and manage our volatility
 17 exposure by buying and selling options below
 18 the market.
 19 Q Are you ever engaging in both of
 20 these strategies at the same time?
 21 A They are dictated by market
 22 conditions. So the norm is that we are doing
 23 one or the other, but there are times when
 24 we do both at the same time.
 25 Q And have these strategies as

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1 Walczak
 2 you've described, have these generally been
 3 the strategies of the fund from 2007 through
 4 the present?
 5 A Yes, for the most part.
 6 Q You mentioned that in 2007 after
 7 the major decline in Harbor Assets you
 8 implemented certain risk parameters. What
 9 were those risk parameters?
 10 A So the other part of our -- or
 11 my analysis in terms of what happened was
 12 that we had too many positions on. So what
 13 does that really mean, you know? Again, as
 14 I looked I said well, we had some delta
 15 impact, but it wasn't a big one. You had
 16 volatility impact, that was really big on a
 17 per position basis and oh, by the way, we
 18 also ran against margin limits and the
 19 number of positions were part of the cause.
 20 I mean, so if you had half the positions,
 21 you had half the drawdown. So my analysis
 22 suggested that we needed to decrease the
 23 number of positions and, again, that's
 24 instructive for both entry and risk, but I
 25 put in as a risk parameter a quantifiable

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1 Walczak
 2 limit of positions per unit of capital that
 3 I would put on.
 4 Q How did you define positions for
 5 that purpose?
 6 A Two different definitions I
 7 used. One before the market in the call
 8 ratio spreads, I counted a position as any
 9 uncovered call option. So really another way
 10 of describing it would be a risk position.
 11 So if I have one long and three shorts, then
 12 I have two risk positions on. And below the
 13 market, to be conservative, I simply counted
 14 any short put as a risk position, even if it
 15 was covered by a long put.
 16 Q Do you recall in 2007, prior to
 17 the drawdown of Harbor Assets, getting any
 18 notification from an FCM about the level of
 19 risk?
 20 A No.
 21 Q How did the fund grow from 2008
 22 to 2013?
 23 A In terms of?
 24 Q In terms of assets under
 25 management.

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1 Walczak
 2 A So size roughly?
 3 Q Yes.
 4 A By 2013 I think we were at about
 5 \$7 million roughly.
 6 Q What were you starting at in
 7 2008, approximately?
 8 A I want to say approximately a
 9 million dollars.
 10 MR. CAZAKOFF: After the
 11 drawdown in 2007, do you remember what
 12 your worth was approximately?
 13 THE WITNESS: What my what was?
 14 MR. CAZAKOFF: What the fund was
 15 worth in 2007 after the drawdown.
 16 THE WITNESS: It was in the
 17 million dollar neighborhood, again,
 18 without looking at a statement.
 19 MR. CAZAKOFF: So did it get as
 20 low as a million dollars in 2008 or do
 21 you that think was --
 22 THE WITNESS: My recollection is
 23 that I started in 2006 with a half
 24 million dollars and in 2007 we did have
 25 inflows from new investors. So, again,

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1 Walczak
 2 without looking at the data, I can't
 3 give you contact numbers, but it's in
 4 that neighborhood.
 5 Q At some point in 2013 the fund
 6 was brought under the Catalyst Capital
 7 Advisors umbrella, correct?
 8 A Correct.
 9 Q Can you explain how that
 10 happened?
 11 A Sure. I got a phone call one day
 12 from George Amrhein at Catalyst, I think the
 13 name is familiar to you, who had business
 14 development responsibility, I believe. All I
 15 knew is that he called and identified
 16 himself as a representative of Catalyst
 17 Capital Advisors and he was interested in
 18 opening a dialogue about converting Harbor
 19 Assets into a 40 Act mutual fund.
 20 Q Did you know him prior to him
 21 calling you?
 22 A No.
 23 Q Complete cold call out of the
 24 blue?
 25 A Correct.

<p style="text-align: right;">Page 69</p> <p>1 Walczak</p> <p>2 Q What was your response?</p> <p>3 A My response was that I didn't</p> <p>4 have any idea about what that meant. I</p> <p>5 didn't understand how a mutual fund</p> <p>6 restructured -- my background was CFTC, NFA,</p> <p>7 commodities stuff, so I didn't really have a</p> <p>8 good handle on what that meant to convert to</p> <p>9 a mutual fund. I had a lot of questions</p> <p>10 about what does that mean to my strategy,</p> <p>11 will the strategy operate in the same way</p> <p>12 under the, you know, in the mutual fund</p> <p>13 world. And most importantly it was</p> <p>14 sufficient -- I do remember reacting not in</p> <p>15 a real favorable way because there were too</p> <p>16 many unknowns. I was reasonably comfortable</p> <p>17 with what I was doing, so I put him off and</p> <p>18 said I don't know anything about this stuff,</p> <p>19 so let me do some homework and maybe I'll</p> <p>20 talk to you later, that's kind of how the</p> <p>21 conversation went.</p> <p>22 Q And then what happened?</p> <p>23 A Best I can recall -- and I think</p> <p>24 that conversation took place, I'm sure it</p> <p>25 took place not later than 2012. It was --</p>	<p style="text-align: right;">Page 71</p> <p>1 Walczak</p> <p>2 concept and tentatively agreed to go ahead.</p> <p>3 MR. SHANK: I think you</p> <p>4 described before that there was a</p> <p>5 significant shift in strategy in the</p> <p>6 2007 time period after that drawdown</p> <p>7 event, correct?</p> <p>8 THE WITNESS: Yes.</p> <p>9 MR. SHANK: And you went from</p> <p>10 basically put selling focus to spread</p> <p>11 trading?</p> <p>12 THE WITNESS: Well, I was always</p> <p>13 doing spread trading and I was always</p> <p>14 doing options -- I was doing the same</p> <p>15 strategy with different option</p> <p>16 structures. There were always spreads,</p> <p>17 never doing anything with naked</p> <p>18 options. The real difference was</p> <p>19 putting in place a risk management</p> <p>20 framework which included limiting</p> <p>21 margin and position sizing and also</p> <p>22 incorporating more volatility analytics</p> <p>23 into the type of positions I put on and</p> <p>24 whether each individual position had a</p> <p>25 certain volatility exposure.</p>
<p style="text-align: right;">Page 70</p> <p>1 Walczak</p> <p>2 I'm pretty sure it was sometime in 2012</p> <p>3 because there was a relatively long period</p> <p>4 of time where we had some occasional</p> <p>5 dialogue and I was trying to do some due</p> <p>6 diligence about, you know, the mutual fund</p> <p>7 environment and what that really meant to</p> <p>8 the kind of trading I was doing. So George</p> <p>9 periodically touched base with me, I would</p> <p>10 ask questions, he would come back with some</p> <p>11 answers. I consulted, you know, a few folks</p> <p>12 to try to get a better understanding of the</p> <p>13 40 Act world. I met at one point with Jerry</p> <p>14 Szilagyi to get a better handle -- in other</p> <p>15 words, so George and I dialogued and it</p> <p>16 didn't move very fast and he suggested I</p> <p>17 meet with Jerry who had business, I think,</p> <p>18 in Milwaukee at some point. So I'm an hour</p> <p>19 and a half from Milwaukee, so Jerry and I</p> <p>20 met and talked through a little bit more the</p> <p>21 mechanics of how this would work. Jerry and</p> <p>22 Catalyst had just converted another, not</p> <p>23 similar strategy, but similar vehicle into a</p> <p>24 mutual fund. So after that conversation, I</p> <p>25 remember being more comfortable with the</p>	<p style="text-align: right;">Page 72</p> <p>1 Walczak</p> <p>2 MR. SHANK: I think you</p> <p>3 described before, you changed your</p> <p>4 focus from trading market movements to</p> <p>5 trading volatility?</p> <p>6 MR. MOYLE: Object to form.</p> <p>7 Go ahead, you can answer.</p> <p>8 THE WITNESS: Yes, I was never</p> <p>9 really trading market movements. I have</p> <p>10 always -- the strategy and that's why</p> <p>11 it's really, again, it's more of a</p> <p>12 similar strategy with modifications to</p> <p>13 the types of spreads and the techniques</p> <p>14 as opposed to, wow, I used to trade</p> <p>15 market movements, now I'm trading</p> <p>16 volatility, that's not the case at all.</p> <p>17 I have always operated a strategy</p> <p>18 neutral to market direction. In other</p> <p>19 words, I have never felt comfortable</p> <p>20 trying to identify where is the market</p> <p>21 going tomorrow or next month or next</p> <p>22 year.</p> <p>23 MR. SHANK: So the shift in</p> <p>24 focus was more along the lines of how</p> <p>25 you sized positions and how you exposed</p>

<p style="text-align: right;">Page 73</p> <p>1 Walczak</p> <p>2 yourself to volatility?</p> <p>3 THE WITNESS: Correct.</p> <p>4 MR. SHANK: Were there any other</p> <p>5 significant changes to your strategy</p> <p>6 between the post 2007 drawdown and when</p> <p>7 you got to Catalyst in 2013?</p> <p>8 MR. MOYLE: Object to form.</p> <p>9 THE WITNESS: I would say,</p> <p>10 again, I'm struggling to recall that</p> <p>11 period of time, but I don't recall</p> <p>12 making any significant or material</p> <p>13 changes to strategy. Again, always</p> <p>14 looking for ways to improve at the</p> <p>15 margin in terms of where do we place</p> <p>16 that spread, is it, you know, plus or</p> <p>17 minus ten points, is it a 50 points</p> <p>18 wide or 40 points wide. So those kind</p> <p>19 of incremental improvement marginal</p> <p>20 technique changes, but the goals, the</p> <p>21 fundamentals around the volatility</p> <p>22 analytics that we do have remained</p> <p>23 pretty constant.</p> <p>24 MR. SHANK: So between 2007 and</p> <p>25 2013, were there any changes that were</p>	<p style="text-align: right;">Page 75</p> <p>1 Walczak</p> <p>2 Q And your wife?</p> <p>3 A And my wife.</p> <p>4 Q No other staff?</p> <p>5 A No.</p> <p>6 Q Did you have an office or was it</p> <p>7 run out of your home?</p> <p>8 A Home.</p> <p>9 Q And that was the case up until</p> <p>10 Catalyst took over the fund?</p> <p>11 A Correct.</p> <p>12 Q What was the name of the fund</p> <p>13 once it was converted under the Catalyst</p> <p>14 umbrella?</p> <p>15 A The Catalyst Hedged Futures</p> <p>16 Strategy Fund.</p> <p>17 Q How did you come up -- were you</p> <p>18 the one that came up with that name?</p> <p>19 A No.</p> <p>20 Q Who came up with that?</p> <p>21 A I don't know specifically who</p> <p>22 did.</p> <p>23 Q Do you think it was a name that</p> <p>24 accurately characterized the strategy?</p> <p>25 A I didn't have any objection to</p>
<p style="text-align: right;">Page 74</p> <p>1 Walczak</p> <p>2 as big of a change as the one you</p> <p>3 implemented in 2007?</p> <p>4 THE WITNESS: No, not at all.</p> <p>5 Q Did the conversion into a 40 Act</p> <p>6 mutual fund cause your strategy to change at</p> <p>7 all?</p> <p>8 A No, that was a fundamental</p> <p>9 concern of mine and why it took -- again, I</p> <p>10 don't have the dates, I do remember it was a</p> <p>11 long period of due diligence on my part and</p> <p>12 I suspect on Catalyst's part as well to try</p> <p>13 and be assured that I could operate the</p> <p>14 strategy as I had operated it in the past</p> <p>15 going forward.</p> <p>16 MR. WASSERMAN: Let's go off the</p> <p>17 record and take a five-minute break.</p> <p>18 (Whereupon, a recess was taken.)</p> <p>19 Q Mr. Walczak, one last question</p> <p>20 about your time at Harbor Financial. At</p> <p>21 Harbor Financial, did you ever have anyone</p> <p>22 devoted to risk management?</p> <p>23 A No, Harbor Financial is</p> <p>24 basically a two-person LLC, myself and my</p> <p>25 wife.</p>	<p style="text-align: right;">Page 76</p> <p>1 Walczak</p> <p>2 the name. The name wasn't important to me,</p> <p>3 to be honest.</p> <p>4 Q Do you think it accurately</p> <p>5 characterized the strategy?</p> <p>6 A Well, I'm not really -- I mean,</p> <p>7 I'm not a lawyer or regulator to understand.</p> <p>8 Q I'm not asking you to be a</p> <p>9 lawyer. I'm just asking your view as to</p> <p>10 whether the name of the fund accurately</p> <p>11 characterized the strategy of the fund?</p> <p>12 A Sure.</p> <p>13 Q Your answer is yes?</p> <p>14 A Yes.</p> <p>15 Q The fund was converted in about</p> <p>16 September 2013; is that correct?</p> <p>17 A Correct.</p> <p>18 Q So in late 2013, do you recall</p> <p>19 whether you were engaging in the above</p> <p>20 market call strategy or the below market put</p> <p>21 strategy?</p> <p>22 A In what time frame, I'm sorry?</p> <p>23 Q Late 2013.</p> <p>24 A Honestly I don't recall.</p> <p>25 Q What about in 2014?</p>

<p style="text-align: right;">Page 77</p> <p>1 Walczak</p> <p>2 A Again, years ago and I don't</p> <p>3 know specifics. I don't want to give you a</p> <p>4 bad answer.</p> <p>5 Q Do you recall whether at any</p> <p>6 point in 2014 you were engaged in the above</p> <p>7 the market call strategy?</p> <p>8 A Again, I don't want to -- again,</p> <p>9 the strategy is driven by volatility market</p> <p>10 conditions and so we can be doing lots of</p> <p>11 different things. So when I think about past</p> <p>12 periods, I think it would be -- I don't want</p> <p>13 to give you bad information. So without</p> <p>14 having a statement in front of me, I can't</p> <p>15 talk about it.</p> <p>16 Q When you say "the strategy is</p> <p>17 driven by volatility market conditions,"</p> <p>18 what do you mean?</p> <p>19 A Well, a fundamental part of the</p> <p>20 strategy, as I mentioned earlier, is to look</p> <p>21 at the term structure of volatility and when</p> <p>22 it's sloping from high on the right side,</p> <p>23 meaning volatility built into options that</p> <p>24 are longer dated to expiration, when that</p> <p>25 volatility is higher than volatility built</p>	<p style="text-align: right;">Page 79</p> <p>1 Walczak</p> <p>2 in the call option strategy.</p> <p>3 MR. SHANK: Can you explain why,</p> <p>4 when volatility is higher on the longer</p> <p>5 dated, that is a trigger for you to use</p> <p>6 the calls?</p> <p>7 THE WITNESS: Sure, because in</p> <p>8 those types of conditions, we have a</p> <p>9 couple of things we are trying to do.</p> <p>10 In those types of condition, typically</p> <p>11 volatility is overall on the low side</p> <p>12 and that generally means a market</p> <p>13 that's going to go sideways or higher.</p> <p>14 And if it goes lower unexpectedly,</p> <p>15 that's okay, too, but when a term</p> <p>16 structure is that shape, we think that</p> <p>17 there is some potential opportunity for</p> <p>18 us to go out and take advantage of the</p> <p>19 higher volatility in the longer dated</p> <p>20 options. And when we put on a position,</p> <p>21 we almost -- we are reasonably</p> <p>22 comfortable that volatility will</p> <p>23 decline and we can make some money with</p> <p>24 a position like that.</p> <p>25 Q Why are you reasonably</p>
<p style="text-align: right;">Page 78</p> <p>1 Walczak</p> <p>2 into options with less time to expiration,</p> <p>3 that is a preliminary trigger for us to</p> <p>4 operate our call option strategy.</p> <p>5 MR. SHANK: Could you read the</p> <p>6 last part?</p> <p>7 MR. WASSERMAN: Let's have the</p> <p>8 answer read back.</p> <p>9 (Whereupon, the record was read</p> <p>10 as requested.)</p> <p>11 Q But you don't recall one way or</p> <p>12 another whether in 2014 you were actually</p> <p>13 engaging in that call strategy?</p> <p>14 A No, I don't.</p> <p>15 Q What about in 2015?</p> <p>16 A Again, any of these time frames,</p> <p>17 without looking at it, I just can't tell you</p> <p>18 what we were doing in that particular day or</p> <p>19 month.</p> <p>20 MR. MOYLE: But is your question</p> <p>21 at any point in the year did he engage</p> <p>22 in that strategy; is that the question?</p> <p>23 MR. WASSERMAN: Yes.</p> <p>24 A I'm reasonably sure that at some</p> <p>25 point during each of those years we engaged</p>	<p style="text-align: right;">Page 80</p> <p>1 Walczak</p> <p>2 comfortable that volatility is going to</p> <p>3 decline in those scenarios?</p> <p>4 A In those scenarios because we</p> <p>5 can see that in the particular market</p> <p>6 conditions that occur. The longer dated</p> <p>7 volatility, for example, is at 13 and the</p> <p>8 VIX is at ten, we know that options we put</p> <p>9 on with 120 days to go or a hundred days to</p> <p>10 go will someday have 30 days to go and all</p> <p>11 else being equal, the volatility built into</p> <p>12 them will go from 13 to ten.</p> <p>13 MR. SHANK: So are you</p> <p>14 suggesting, though, in that scenario,</p> <p>15 you are short volatility?</p> <p>16 THE WITNESS: Yes.</p> <p>17 MR. SHANK: Maybe I</p> <p>18 misunderstood your description of your</p> <p>19 strategy before, I thought you were</p> <p>20 positioning yourself to ensure that you</p> <p>21 were at least neutral or positive</p> <p>22 volatility with each of your positions?</p> <p>23 THE WITNESS: That is true for</p> <p>24 positions below the market.</p> <p>25 MR. SHANK: So for your call</p>

<p style="text-align: right;">Page 81</p> <p>1 Walczak</p> <p>2 strategy, that isn't true?</p> <p>3 THE WITNESS: Correct.</p> <p>4 MR. SHANK: So as far as your</p> <p>5 call strategy, you need to be short</p> <p>6 volatility?</p> <p>7 THE WITNESS: We want to be</p> <p>8 short volatility.</p> <p>9 Q Is it accurate that that</p> <p>10 manifests itself in establishing a net short</p> <p>11 position for options that are approximately</p> <p>12 90 days out?</p> <p>13 A Can you repeat that again?</p> <p>14 Q Does that manifest itself in</p> <p>15 establishing -- in selling more calls than</p> <p>16 you are buying for that longer dated</p> <p>17 expiration?</p> <p>18 A That's what our positions</p> <p>19 typically look like, yes.</p> <p>20 Q Do you recall whether in 2014</p> <p>21 and 2015, to the extent you were engaged in</p> <p>22 the call options strategy, whether the</p> <p>23 typical ratio was buy one sell two or buy</p> <p>24 one sell three?</p> <p>25 A I don't recall that specific,</p>	<p style="text-align: right;">Page 83</p> <p>1 Walczak</p> <p>2 whether 15, 16 months ago you were engaged</p> <p>3 primarily in the call option strategy?</p> <p>4 A And, again, not to evade the</p> <p>5 question in any way, I honestly can't</p> <p>6 remember without looking at the details of</p> <p>7 what was going on.</p> <p>8 Q Do you recall what your</p> <p>9 positions were in December of 2016?</p> <p>10 A Same thing. I mean, I don't know</p> <p>11 how else to answer the question without</p> <p>12 going back and looking at the records --</p> <p>13 Q You had a major drawdown in the</p> <p>14 fund in early December of 2016, correct?</p> <p>15 A Yes.</p> <p>16 Q That was a significant event,</p> <p>17 correct?</p> <p>18 A Oh, I'm sorry, I misheard your</p> <p>19 time frame then. Yes, yes.</p> <p>20 Q You typically put positions on</p> <p>21 how long in advance of expiry?</p> <p>22 A It depends, again, on the</p> <p>23 volatility analytics, the typical time frame</p> <p>24 is 90 to 120 days.</p> <p>25 Q So three to four months,</p>
<p style="text-align: right;">Page 82</p> <p>1 Walczak</p> <p>2 no.</p> <p>3 Q What about in 2016, same</p> <p>4 question?</p> <p>5 A I just don't recall the</p> <p>6 specifics because at various times we use</p> <p>7 one by two's and one by three's.</p> <p>8 Q And in 2016 you were engaged, at</p> <p>9 least by spring 2016, you were engaged</p> <p>10 primarily, if not exclusively, in the call</p> <p>11 option strategy, correct?</p> <p>12 A What period of time again?</p> <p>13 Q Spring 2016 forward.</p> <p>14 A I'm not certain that we were not</p> <p>15 doing puts during that time.</p> <p>16 Q In the spring and summer of</p> <p>17 2016, were you primarily engaged in the call</p> <p>18 options strategy?</p> <p>19 A Again, without a broker's</p> <p>20 statement in front of me, I can't tell you.</p> <p>21 Q Mr. Walczak, this is what you've</p> <p>22 done every day for the least 12, 13 years,</p> <p>23 right?</p> <p>24 A Yes, it is.</p> <p>25 Q I'm asking if you remember</p>	<p style="text-align: right;">Page 84</p> <p>1 Walczak</p> <p>2 correct?</p> <p>3 A Right.</p> <p>4 Q So you recall the drawdown in</p> <p>5 December of 2016, correct?</p> <p>6 A I do.</p> <p>7 Q We will probably get to that in</p> <p>8 more detail in a little while. But I'm</p> <p>9 asking, at the time you put on those</p> <p>10 positions, which would have been</p> <p>11 approximately late summer of 2016, according</p> <p>12 to your typical practice, do you recall</p> <p>13 whether you were primarily engaged in the</p> <p>14 call options strategy or the put options</p> <p>15 strategy?</p> <p>16 A I can't tell you it wasn't both.</p> <p>17 Q Do you recall --</p> <p>18 MR. SHANK: If you reviewed the</p> <p>19 portfolio, you would be able to tell</p> <p>20 us?</p> <p>21 THE WITNESS: Absolutely.</p> <p>22 Q Do you recall whether the</p> <p>23 positions you put on for December expiry</p> <p>24 were primarily the call options strategy or</p> <p>25 the put options strategy?</p>

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2 A I don't recall if we had any put
3 options on. I do recall that we had call
4 options on into that December time frame.

5 MR. MOYLE: Can I try to help
6 out?

7 MR. WASSERMAN: One more
8 question.

9 Q At the time that you put on
10 those call options positions for December
11 expiry, was your ratio one by two or one by
12 three?

13 A I believe it was one by three.

14 MR. MOYLE: When he's asking you
15 these questions, I don't think he's
16 trying to ask you with such specificity
17 that if you go to a particular date and
18 maybe the portfolio is a blend of the
19 two strategies or whatever, that it's
20 going to be a got-you moment. I think
21 he's just asking you more generally,
22 you know --

23 THE WITNESS: Fair enough.

24 MR. MOYLE: -- what would you
25 expect your focus was during this

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2 period of time as opposed to maybe
3 there are days that are different, but
4 just generally speaking.

5 Is that correct, Sam?

6 MR. WASSERMAN: That's right.

7 Q So do you recall whether in the
8 summer of 2016 you were primarily engaging
9 in the call options strategy?

10 A Yes. What I remember is that the
11 call option strategy was the source of the
12 drawdown in 2016. What I don't remember for
13 sure is whether we were also doing the put
14 option strategy in that time frame.

15 Q More specifically your
16 recollection was that the call option
17 strategy at the time entailed a ratio of one
18 long to three short?

19 A That's the best of my
20 recollection, yes.

21 Q In 2016 to implement your call
22 option strategy, how did you determine where
23 to put the positions on?

24 A So the first level of analytics,
25 as I had mentioned before, is to look at the

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2 term structure of volatility and that tells
3 us a couple of things. It tells us whether
4 or not we should be looking at calls or
5 puts. Again, sometimes market fluctuation
6 cannot necessarily get us in both
7 simultaneously, but, for example, we might
8 put on a call position today, tomorrow you
9 get some sort of event that flattens the
10 curve sufficiently and then we put on a put
11 position. The event subsides, the curve goes
12 back this way and then we go to call. So
13 that's in practice how it can be that we do
14 both pretty much at once. But in direct
15 answer to your question, we look at the term
16 structure of volatility when it's steep,
17 then we go up the curve until we can find
18 the greatest volatility that has some real
19 world liquidity around it, meaning it's
20 tradable in the products we trade. And so
21 once we found that spot where -- and the way
22 the curve typically behaves is you get more
23 volatility and more volatility and more
24 volatility and then all of a sudden you
25 don't get much more, so the curve starts to

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2 flatten. We look for that spot because
3 that's where we are not going to get
4 significantly more volatility going further.
5 Once we find that spot, that determines an
6 expiration month for us. Now, within that
7 expiration month, we now want to place these
8 positions in such that we have -- we feel
9 like there is not a high chance that the
10 market will go past the short side of the
11 spread because that's where our risk is. How
12 do we determine that? We don't use
13 statistics about market movement I think for
14 a little bit of the reason I described
15 earlier. In other words, we don't take a
16 volatility and say, gees, there is only a
17 five percent chance that the market goes
18 this high because markets behave, in my
19 experience, don't always conform to those
20 pure mathematical price movements. So we do
21 a couple different things. We try to project
22 market levels, potential market levels, on
23 the basis of some technical analysis,
24 technical analysis means things like trend
25 lines on a chart, trying to determine the

<p style="text-align: right;">Page 89</p> <p>1 Walczak</p> <p>2 rough rate of advance of the market. We try</p> <p>3 to marry those analytics up with things like</p> <p>4 price earnings ratios and any other</p> <p>5 fundamental calls, research from other</p> <p>6 analysts in the marketplace who might make,</p> <p>7 for example, a year-end call.</p> <p>8 Q What do you mean "a year-end</p> <p>9 call"?</p> <p>10 A Meaning, so if we are sitting in</p> <p>11 February of 2016 and we get a consensus view</p> <p>12 from the top eight investment banks that,</p> <p>13 you know, year-end 2016 price target for the</p> <p>14 S&P is 2750, we will then assume a rate of</p> <p>15 advance into that 2750 as sort of a best</p> <p>16 approximation of the path the market may</p> <p>17 take to get to year end. And that's one --</p> <p>18 and so we try to marry the technical</p> <p>19 analysis of looking at price patterns,</p> <p>20 stock -- index charts and other metrics and</p> <p>21 that allows us to place spreads in a place</p> <p>22 where we have an opportunity that, if the</p> <p>23 market follows a normal course, the position</p> <p>24 will be profitable. If the market goes</p> <p>25 sideways or even lower, the position is</p>	<p style="text-align: right;">Page 91</p> <p>1 Walczak</p> <p>2 short calls above where you think that line</p> <p>3 is going to be, correct?</p> <p>4 A Correct.</p> <p>5 Q Specifically because if the</p> <p>6 market goes above that short strike price,</p> <p>7 you start to lose money?</p> <p>8 A You actually don't lose money</p> <p>9 until, in the case of a one by three, until</p> <p>10 it's, you know -- we typically use something</p> <p>11 around a 50 point strike spread, so the</p> <p>12 actual point of loss at expiration on a one</p> <p>13 by three is 25 points higher than the short</p> <p>14 strike. I'm sorry -- yes, it is, 25 points.</p> <p>15 Q Wouldn't it be a third of 50?</p> <p>16 A No, 50 points on your one by</p> <p>17 one, two options short eat up your 50 points</p> <p>18 25 points later.</p> <p>19 Q If your spread is 50, in other</p> <p>20 words, if your long strike is 2250 and your</p> <p>21 short strike is 2300, at 2325, your long</p> <p>22 strike has a profit of 75, right?</p> <p>23 A Right.</p> <p>24 Q And your short strikes have a</p> <p>25 loss of 75, okay, I'm with you.</p>
<p style="text-align: right;">Page 90</p> <p>1 Walczak</p> <p>2 likely to be a break-even and it gives us</p> <p>3 that first approximation of where our risk</p> <p>4 is and where our positions should be placed.</p> <p>5 Q Do you specifically draw a</p> <p>6 straight line from the price today to the</p> <p>7 bank's prediction of where the market is</p> <p>8 going to be at the end of the year?</p> <p>9 A We will draw that -- we</p> <p>10 typically draw multiple lines and then try</p> <p>11 to resolve any discrepancies. Meaning,</p> <p>12 that's one line we can draw. If we draw the</p> <p>13 line and we discover the price action has</p> <p>14 already pierced the line at some point, then</p> <p>15 we have to adjust that line to account for</p> <p>16 the fact that the market is doing something</p> <p>17 that would tend to invalidate that line.</p> <p>18 Q Generally speaking you want to</p> <p>19 place the strike price of your short calls</p> <p>20 at any point below that line or where you</p> <p>21 think that line is going to be; is that</p> <p>22 accurate?</p> <p>23 A Actually above the line.</p> <p>24 Q I'm sorry, yes, I misspoke. So</p> <p>25 you want to place the strike price of your</p>	<p style="text-align: right;">Page 92</p> <p>1 Walczak</p> <p>2 A Okay.</p> <p>3 MR. SHANK: What, if anything,</p> <p>4 have you historically done to test how</p> <p>5 your positions will perform if the</p> <p>6 market does take an unexpected turn?</p> <p>7 THE WITNESS: Well, we don't so</p> <p>8 much test history so much as we have</p> <p>9 lived history, we have operated the</p> <p>10 strategy over time.</p> <p>11 MR. SHANK: I'm sorry, I didn't</p> <p>12 mean testing history. I mean</p> <p>13 historically how have you approached</p> <p>14 analyzing how your positions will</p> <p>15 perform if the market takes an</p> <p>16 unexpected turn?</p> <p>17 THE WITNESS: Well, we have,</p> <p>18 again, the risk framework in place and</p> <p>19 we generally know how the strategy</p> <p>20 works. So we know that if the market</p> <p>21 unexpectedly rises very rapidly, then</p> <p>22 we have to make adjustments to these</p> <p>23 positions, so we know that's where we</p> <p>24 have risk to the up side.</p> <p>25 Q Is there anything else you do,</p>

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 2 aside from the items you mentioned, to
 3 determine what strike prices to buy your
 4 calls at, to buy and sell your calls at?
 5 A Well, the other thing we do --
 6 well, among the other things we do is we
 7 have -- it's a sifting process like a lot of
 8 investment processes, so the first layer is
 9 that shape of the term structure and that
 10 gets us to an expiration month. We will then
 11 look at our analytics around where we think
 12 price might be, we will look at our general
 13 rules around how that spread should look and
 14 then we actually go into the marketplace.
 15 And what I really mean before we actually go
 16 to the marketplace and execute an order, we
 17 go and we look at actual options pricing and
 18 say now, all the models and theories have
 19 pointed us here, can we actually execute
 20 this trade given real prices in the market.
 21 And we then also compare at that point -- we
 22 have chosen an expiration month, however, we
 23 typical use the two liquid expiration
 24 periods in a month, the third Friday and the
 25 end of month, so we can side by side look

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 2 and see whether we have a volatility
 3 advantage one way or the other that's not
 4 present in our top line at the money sort of
 5 volatility analytics. So we will compare,
 6 using your example of 2250 and 2300, and
 7 let's say we have chosen a December
 8 expiration, we will look at 2200, 2250, and
 9 2300, A, is it above the line, all right, if
 10 that box gets checked, then we look, what
 11 kind of volatility are we getting for the
 12 short options, what if we move this thing
 13 out to end of December instead of third
 14 Friday of December, do we get the same
 15 volatility, do we get a nice pop in
 16 volatility because each option has that kind
 17 of unique characteristic.
 18 Q When you say do we get a pop in
 19 volatility, does the price of that option in
 20 the market reflect a greater volatility?
 21 A Correct.
 22 Q A greater implied volatility?
 23 A Greater implied volatility,
 24 exactly.
 25 MR. SHANK: Is there a

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 2 mechanical approach to this where you
 3 are actually doing some sort of data
 4 analytics or is it more judgment-based?
 5 THE WITNESS: Well, we like to
 6 describe the strategy as a 75 percent
 7 systematic, 25 percent judgment because
 8 so far, really what I have described to
 9 you is very systematic. The judgment
 10 part comes in really around adjusting
 11 positions and taking profits. So we
 12 have -- I mean when we look it, just as
 13 I described to you, these are numbers
 14 that we are looking at and we have
 15 these trading entry rules that we use
 16 to evaluate.
 17 Q What are the trading entry
 18 rules?
 19 A Well, as I said, if the curve's
 20 in contango, that's sloping down from right
 21 to left on the chart.
 22 Q What curve?
 23 A The term structure of
 24 volatility. So if -- that's when we
 25 generally look for call positions and so

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 2 forth.
 3 Q I see. I thought you were
 4 referring to trade entry rules specific to
 5 the call option strategy after you have
 6 already decided to engage in the call option
 7 strategy?
 8 A No, that's, again, that's just
 9 the end product of all these analytics that
 10 we do.
 11 Q Engaging in the strategy itself
 12 is the end product of all the analytics you
 13 do?
 14 A The actual executing of a spread
 15 order at exactly which strike price and
 16 which expiration month is the end result of
 17 this process.
 18 Q That you have described before?
 19 A Right.
 20 Q Why do you typically sell the
 21 short strikes 50 points above where you buy
 22 the long strikes?
 23 A So at various times, as I think
 24 I mentioned, we had done one by two spreads
 25 and it is kind of an experience-based thing

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2 as well as a research-based. In other words,
3 experientially, there are periods of time
4 where an adjustment technique we used was to
5 take a one by two, buy back one of the short
6 options, in some cases both of the short
7 options, and put another one by two, which
8 ended up making a one by four. We started
9 doing the one by two's at 25 points wide.
10 Again, that was some actual research that I
11 took away from one of the options seminars
12 that I attended way back when. So we started
13 at a 25 point basis, discovered that we were
14 often ending up with a one by four at 50
15 points wide and did a little research and
16 determined -- research meaning simply going
17 back in market history and identifying what
18 prices were available and what the risk
19 profile or the P&L profile of that position
20 looked like. And it's clear to me that a
21 one by three 50 points wide is better than a
22 one by four 50 points wide.
23 Q And that's based on back-testing
24 it somehow?
25 A Well, back-testing means --

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2 again, we aren't able to automate this and
3 do a Monte Carlo. We are able to go back
4 into market history and identify options
5 pricing and market pricing and it's a manual
6 back-test.
7 Q I see. Manually identified
8 instances where a one by three would have
9 been more profitable than what you had been
10 doing before?
11 A Correct.
12 MR. SHANK: Did you create any
13 documentation analyses like
14 spreadsheets or anything like that
15 analyzing that?
16 THE WITNESS: I did not.
17 Certainly prior to conversion, you
18 know, I was a one-man shop, so I
19 didn't.
20 MR. SHANK: So how did you go
21 about analyzing?
22 THE WITNESS: Well, I simply sat
23 down and went back in time and
24 identified, you know, on an option
25 model and fast forward to see how the

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2 position would perform, but I simply
3 didn't maintain any record of that.
4 MR. SHANK: At the time did you
5 record anything? I'm just trying to
6 understand how you would actually see
7 patterns without actually creating
8 spreadsheets or in some way recording
9 your analysis.
10 THE WITNESS: I don't recall
11 recording anything. I simply satisfied
12 myself through multiple repetitions of
13 this that it was a favorable strategy.
14 Q How many points in time did you
15 look at to see whether the one by three
16 strategy was profitable or at least more
17 profitable than what you had been doing
18 previously with a one by two or one by four?
19 A Again, and we still occasionally
20 use one by two's now and so a lot of it is
21 just pure experiential. Again, I didn't
22 record anything, so I don't have anything I
23 can tell you, well, I tested 11 times and it
24 always worked.
25 Q Can you approximate on how many

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1 Walczak
2 discrete historical dates you tested it on?
3 A No.
4 Q Would you say it was a half
5 dozen times, a dozen times?
6 A At least that many. Maybe more.
7 MR. SHANK: I'm just trying to
8 understand what exactly you did. So you
9 went back historically and just picked
10 random positions and saw how they
11 played out?
12 THE WITNESS: Yes.
13 MR. SHANK: How many iterations
14 of that did you to?
15 THE WITNESS: Again, this is in
16 between sort of operating the fund,
17 doing lots of research, doing homework,
18 testing a wide variety of different
19 positions, not just those and so I just
20 don't really have any way of putting a
21 number to it.
22 Q Were you using a computer
23 program to do it or were you just doing it
24 in your head and on paper?
25 A Oh, no, at that point I would

<p style="text-align: right;">Page 101</p> <p>1 Walczak</p> <p>2 have been doing Option View. Again, I don't</p> <p>3 recall exactly when I started using Option</p> <p>4 View, which is the software I use today, but</p> <p>5 it was pretty early in the life of the fund.</p> <p>6 Q I'm sorry, at what point? You</p> <p>7 said you don't recall exactly at that point</p> <p>8 what you were doing, what point were you</p> <p>9 referring to?</p> <p>10 A Meaning when -- I think you</p> <p>11 asked about what I was doing to do this test</p> <p>12 and I was certainly using options analytic</p> <p>13 software and it was likely Option View.</p> <p>14 Q So does Option View allow you to</p> <p>15 do the type of back-testing that you are</p> <p>16 referring to?</p> <p>17 A Yes, Option View retains option</p> <p>18 pricing -- real-time option pricing going</p> <p>19 back, I think, ten years.</p> <p>20 MR. SHANK: How far back did you</p> <p>21 go when you were testing this?</p> <p>22 THE WITNESS: I didn't have a</p> <p>23 specific -- in other words, remember,</p> <p>24 our trade duration is, you know, 90,</p> <p>25 120 days, so it's not really -- I</p>	<p style="text-align: right;">Page 103</p> <p>1 Walczak</p> <p>2 A So when we converted the fund, I</p> <p>3 had, again, coming out of 2007, I put</p> <p>4 together a risk matrix. I added, deleted,</p> <p>5 modified over time, but the main parts were</p> <p>6 pretty constant since 2007. When we</p> <p>7 converted the mutual fund, I continued to</p> <p>8 use that risk matrix. At some point as the</p> <p>9 fund grew, Catalyst elected to appoint a</p> <p>10 chief risk officer, which they had not had</p> <p>11 before and he and I collaborated. Basically</p> <p>12 he asked what sort of risk matrix I used to</p> <p>13 manage risk in the portfolio and I provided</p> <p>14 him, you know, a -- really kind of a draft</p> <p>15 of what I was using for his consideration.</p> <p>16 And he and I went back and forth on it and</p> <p>17 focused on a final product, which I think</p> <p>18 you guys probably have.</p> <p>19 MR. SHANK: When did Catalyst</p> <p>20 appoint that chief risk officer?</p> <p>21 THE WITNESS: That I don't</p> <p>22 remember.</p> <p>23 MR. SHANK: Well, the fund</p> <p>24 started in 2013, correct?</p> <p>25 THE WITNESS: Right.</p>
<p style="text-align: right;">Page 102</p> <p>1 Walczak</p> <p>2 certainly didn't go back five years and</p> <p>3 try to follow positions because they</p> <p>4 turn. It's more a circumstance of when</p> <p>5 we do research -- when I do research,</p> <p>6 looking for specific market conditions</p> <p>7 and say, all right, how do these two</p> <p>8 compare in a market that was flat and</p> <p>9 then there is a period of time, well, I</p> <p>10 know this is a place where the market</p> <p>11 went through the roof, how do they</p> <p>12 behave in that environment. So I would</p> <p>13 test just randomly selected market</p> <p>14 environments where either I recalled</p> <p>15 what the market was doing or I could</p> <p>16 look at a chart and say this would be a</p> <p>17 good place to see the difference in</p> <p>18 these spreads.</p> <p>19 Q And this was always backwards</p> <p>20 looking, correct?</p> <p>21 A Yes.</p> <p>22 Q When the strategy was under the</p> <p>23 Catalyst umbrella as Hedged Futures Strategy</p> <p>24 Fund, how did you monitor the risk</p> <p>25 associated with the portfolio?</p>	<p style="text-align: right;">Page 104</p> <p>1 Walczak</p> <p>2 MR. SHANK: So it's about four</p> <p>3 years?</p> <p>4 THE WITNESS: Right.</p> <p>5 MR. SHANK: Was it early on in</p> <p>6 the life of the fund, was it in the</p> <p>7 last year or two?</p> <p>8 THE WITNESS: It was -- honestly</p> <p>9 I don't recall. It was probably not --</p> <p>10 it certainly was not present when I</p> <p>11 started the fund. The guy has been</p> <p>12 around for more than a year.</p> <p>13 MR. SHANK: Who was it?</p> <p>14 THE WITNESS: George Amrhein.</p> <p>15 MR. SHANK: Prior to the</p> <p>16 employment of the chief risk officer,</p> <p>17 had anyone at Catalyst asked to see</p> <p>18 your risk matrix or asked for an</p> <p>19 explanation as to how you monitored</p> <p>20 risk?</p> <p>21 THE WITNESS: I don't recall</p> <p>22 specifically other than Jerry Szilagyi</p> <p>23 and I have had discussions on risk.</p> <p>24 MR. SHANK: Well, do you</p> <p>25 remember at any point early on in the</p>

<p style="text-align: right;">Page 105</p> <p>1 Walczak</p> <p>2 fund's life or even before its launch</p> <p>3 having discussions or going over the</p> <p>4 risk management program with Mr.</p> <p>5 Szilagyi or with someone else?</p> <p>6 THE WITNESS: The first time I</p> <p>7 formally remember providing my risk</p> <p>8 matrix was to George, whenever he was</p> <p>9 appointed.</p> <p>10 MR. CAZAKOFF: When George was</p> <p>11 trying to get your fund under the</p> <p>12 Catalyst umbrella, what was his role</p> <p>13 with Catalyst at that point?</p> <p>14 THE WITNESS: I believe he was</p> <p>15 business development and business</p> <p>16 development means looking for funds</p> <p>17 like mine and strategies like mine that</p> <p>18 might fit Catalyst's fund profile.</p> <p>19 MR. CAZAKOFF: In your</p> <p>20 discussions, did you have any high</p> <p>21 level discussions about risk with</p> <p>22 George during those phone calls when he</p> <p>23 was trying to get your business?</p> <p>24 THE WITNESS: I don't recall</p> <p>25 that -- I don't recall having any.</p>	<p style="text-align: right;">Page 107</p> <p>1 Walczak</p> <p>2 dated December 2014 was marked</p> <p>3 Commission Exhibit 4 for</p> <p>4 identification, as of this date.)</p> <p>5 Q Mr. Walczak, I have placed in</p> <p>6 front of you a document Bates stamped</p> <p>7 Catalyst 003 03055. Do you recognize this</p> <p>8 document?</p> <p>9 A I have seen similar documents.</p> <p>10 I don't recognize this one specifically.</p> <p>11 Q The document is titled "Hedged</p> <p>12 Futures Strategy Fund risk guidelines,</p> <p>13 December 2014." Could you take a moment to</p> <p>14 review the contents of the document?</p> <p>15 A Okay.</p> <p>16 Q Are the risk parameters and</p> <p>17 metrics listed on this sheet the same risk</p> <p>18 parameters and metrics that you had</p> <p>19 established at Harbor?</p> <p>20 A They are similar. Some are the</p> <p>21 same. This looks like potentially a work in</p> <p>22 process because I recognize some of it and I</p> <p>23 recognize that some of it is not what I</p> <p>24 used.</p> <p>25 Q There are only seven of them,</p>
<p style="text-align: right;">Page 106</p> <p>1 Walczak</p> <p>2 MR. CAZAKOFF: Did you have any</p> <p>3 insight into his familiarity -- into</p> <p>4 his knowledge about risk when he got</p> <p>5 the role of CRO?</p> <p>6 THE WITNESS: No, I wasn't</p> <p>7 completely familiar with his</p> <p>8 background, however, I found him to be</p> <p>9 a competent guy.</p> <p>10 Q Aside from the parameters that</p> <p>11 were in your risk metrics that you had</p> <p>12 developed, what other tools did you use or</p> <p>13 in what other ways did you monitor the risk</p> <p>14 of the fund in the Catalyst period?</p> <p>15 MR. MOYLE: Can you repeat that</p> <p>16 question.</p> <p>17 (Whereupon, the record was read</p> <p>18 as requested.)</p> <p>19 A The risk matrix was very</p> <p>20 specifically and exclusively what I depended</p> <p>21 on to monitor the risk. There weren't any</p> <p>22 ancillary metrics.</p> <p>23 MR. WASSERMAN: If we could mark</p> <p>24 this document as Exhibit 4.</p> <p>25 (Photocopy of risk guidelines,</p>	<p style="text-align: right;">Page 108</p> <p>1 Walczak</p> <p>2 let's go through them. The first one is</p> <p>3 titled "Strategy, Markets Traded" and the</p> <p>4 metric is, "No positions in markets outside</p> <p>5 of S&P 500 futures," was that one of your</p> <p>6 risk parameters that you had developed?</p> <p>7 A Let me answer it this way, I</p> <p>8 didn't use that prior to Catalyst because I</p> <p>9 was doing the trading and I wasn't going to</p> <p>10 trade outside of these markets. So that was</p> <p>11 something that was added.</p> <p>12 Q Number two is, "Futures</p> <p>13 Positions" and the metric is, "No futures</p> <p>14 positions open overnight," was that</p> <p>15 something that was part of the risk matrix</p> <p>16 that you had developed?</p> <p>17 A Same answer really, I didn't use</p> <p>18 it prior to Catalyst, but I remember that</p> <p>19 this was part of my proposal to them,</p> <p>20 recognizing it was appropriate to centralize</p> <p>21 risk oversight, not just me.</p> <p>22 Q The third one is that margin,</p> <p>23 defined as exchange minimum, to AUM ratio is</p> <p>24 less than 80 percent, is that metric one</p> <p>25 that was part of your risk matrix that you</p>

<p style="text-align: right;">Page 109</p> <p>1 Walczak</p> <p>2 had developed?</p> <p>3 A Yes.</p> <p>4 Q And what exactly does that mean?</p> <p>5 A That means that if we calculate</p> <p>6 the collateral requirement or margin</p> <p>7 requirement from our FCM's or FCM, we can't</p> <p>8 allow it to or we get a trigger when it hits</p> <p>9 80 percent, so we want to keep it less than</p> <p>10 80 percent.</p> <p>11 Q Is it accurate to say that --</p> <p>12 well, the margin as defined here, is that</p> <p>13 the collateral that the FCM's are requiring</p> <p>14 you to post in connection with your options</p> <p>15 positions?</p> <p>16 A We define it as exchange</p> <p>17 minimum, so some FCM's will require more</p> <p>18 than exchange minimum, but for continuity</p> <p>19 across these different kinds of</p> <p>20 requirements, that is the collateral.</p> <p>21 Q So the metric didn't relate to</p> <p>22 the margin that you actually had to post, it</p> <p>23 related to the minimum that you had to post</p> <p>24 according to exchange rules?</p> <p>25 A Correct, and it's not unusual</p>	<p style="text-align: right;">Page 111</p> <p>1 Walczak</p> <p>2 document that action needs to be taken?</p> <p>3 A Again, it's a draft, but it</p> <p>4 looks as though it does.</p> <p>5 Q The document speaks for itself,</p> <p>6 but it doesn't say -- it says that the</p> <p>7 corrective action is that the portfolio</p> <p>8 manager is to give a written explanation,</p> <p>9 correct, according to the document?</p> <p>10 A I think the --</p> <p>11 Q I'm sorry, that's my fault, I'm</p> <p>12 looking at the wrong line.</p> <p>13 The document says "PM reduces</p> <p>14 ratio 24 hours," what does that mean?</p> <p>15 A That means that some action</p> <p>16 should be taken so that the margin</p> <p>17 requirement -- within 24 hours of the margin</p> <p>18 requirement is reduced to under 80 percent.</p> <p>19 Q Does the margin risk metric,</p> <p>20 specifically does the requirement that the</p> <p>21 theoretical minimum margin be less than 80</p> <p>22 percent of AUM, tell you anything about how</p> <p>23 the fund will perform under certain market</p> <p>24 conditions?</p> <p>25 A No.</p>
<p style="text-align: right;">Page 110</p> <p>1 Walczak</p> <p>2 for that to be the same number.</p> <p>3 Q But it doesn't have to be?</p> <p>4 A But it doesn't have to be.</p> <p>5 Q So the theoretical minimum</p> <p>6 amount that you would be required to post as</p> <p>7 margin needed to be less than 80 percent of</p> <p>8 your assets under management?</p> <p>9 A Correct.</p> <p>10 Q Then a signal would be triggered</p> <p>11 if that margin was above 80 percent of your</p> <p>12 assets under management?</p> <p>13 A Correct.</p> <p>14 Q And what action is required when</p> <p>15 that signal is triggered?</p> <p>16 A Well, I'll answer this in a</p> <p>17 moment, but to step back and recall that as</p> <p>18 I look at this document, this is not a</p> <p>19 document that -- a final document that I</p> <p>20 felt like was in place, but consistent with</p> <p>21 all of the risk matrix in the ultimate</p> <p>22 document, when they are triggered, action</p> <p>23 has to be taken to mitigate or to reduce the</p> <p>24 margin to under the limit.</p> <p>25 Q But it doesn't say in this</p>	<p style="text-align: right;">Page 112</p> <p>1 Walczak</p> <p>2 Q The fourth parameter is titled</p> <p>3 "Open Options Premium Value," specifically</p> <p>4 "Net call or put value less than eight</p> <p>5 percent of AUM," was that metric one of the</p> <p>6 metrics that you had come up with in your</p> <p>7 own risk matrix?</p> <p>8 A Yes.</p> <p>9 Q What specifically did you intend</p> <p>10 that risk parameter to mean?</p> <p>11 A Well, what that's a measure of</p> <p>12 is, as I mentioned, it -- typically as we</p> <p>13 enter positions, we are entering positions</p> <p>14 somewhere close to even money. In other</p> <p>15 words, we are not taking in, we are not</p> <p>16 generically taking in, again, we do</p> <p>17 sometimes, but this is meant to reflect a</p> <p>18 circumstance where our open option premium,</p> <p>19 something has happened in the marketplace</p> <p>20 that inflates the open option premium in the</p> <p>21 portfolio to a certain level, in this case,</p> <p>22 eight percent of capital.</p> <p>23 Q And how specifically do you</p> <p>24 measure open option premium value?</p> <p>25 A The important word here is that</p>

<p style="text-align: right;">Page 113</p> <p>1 Walczak</p> <p>2 it's net, meaning we will calculate the</p> <p>3 value of long option positions and the value</p> <p>4 of short option positions and net the two</p> <p>5 and determine this number.</p> <p>6 Q So if you are long options worth</p> <p>7 \$5 million and short options worth \$5</p> <p>8 million, what's the number?</p> <p>9 A Zero.</p> <p>10 Q So in situations where you are</p> <p>11 short options that are worth more than the</p> <p>12 options that you are long, will this number</p> <p>13 ever be positive?</p> <p>14 A Could you repeat that?</p> <p>15 Q If your portfolio is short</p> <p>16 options that have a greater -- that in the</p> <p>17 aggregate have a greater value than the</p> <p>18 options that you are long, will this number</p> <p>19 ever be positive?</p> <p>20 A The number will be expressed as</p> <p>21 a positive number, because it's meant,</p> <p>22 again, this is a draft, so it's not well</p> <p>23 defined, but it is meant to reflect that net</p> <p>24 short option premium.</p> <p>25 Q Well, let's take the</p>	<p style="text-align: right;">Page 115</p> <p>1 Walczak</p> <p>2 circumstance as zero.</p> <p>3 Q Why?</p> <p>4 A Because this is meant to</p> <p>5 identify a risk in the portfolio and net</p> <p>6 long option positions, at least the way I</p> <p>7 designed it, that's not a risk.</p> <p>8 Q Well, you have a risk of losing</p> <p>9 all your premium, don't you?</p> <p>10 A Sure, but that's not the type of</p> <p>11 risk we are measuring here.</p> <p>12 Q Well, did the risk metric that</p> <p>13 you had in your rubric that you created</p> <p>14 state that you would only measure short</p> <p>15 exposure?</p> <p>16 A In how I used it, yes.</p> <p>17 Q I see. So in the metric that you</p> <p>18 created and you used at Harbor, you were</p> <p>19 only looking at the value of net short</p> <p>20 exposure compared to assets under</p> <p>21 management?</p> <p>22 A Short options value, not short</p> <p>23 market exposure.</p> <p>24 Q Right. So if you were short</p> <p>25 \$9,000,000 worth of options in a hundred</p>
<p style="text-align: right;">Page 114</p> <p>1 Walczak</p> <p>2 hypothetical that if you are long \$5 million</p> <p>3 worth of options and short \$5 million worth</p> <p>4 of options, this number is zero, correct?</p> <p>5 A Correct.</p> <p>6 Q And if you are only long \$5</p> <p>7 million worth of options, the number will be</p> <p>8 five divided by AUM, right?</p> <p>9 A In that case, again, sure it</p> <p>10 would be, but that's not really a risk</p> <p>11 factor, that's not intended to measure net</p> <p>12 long option premium.</p> <p>13 Q Let's take the hypothetical</p> <p>14 because you are engaged in going long and</p> <p>15 short options, correct?</p> <p>16 A (Indicating.)</p> <p>17 Q So let's take the hypothetical</p> <p>18 where you have a \$1 million portfolio?</p> <p>19 A (Indicating.)</p> <p>20 Q And you are long \$5 million</p> <p>21 worth of options, this risk metric number</p> <p>22 would be five, right, your options value is</p> <p>23 five percent of your overall assets under</p> <p>24 management, correct?</p> <p>25 A I would report a number in that</p>	<p style="text-align: right;">Page 116</p> <p>1 Walczak</p> <p>2 million dollar portfolio, that would violate</p> <p>3 this risk metric?</p> <p>4 A Yes.</p> <p>5 Q But as the risk metric is</p> <p>6 written in this document, if you were short</p> <p>7 \$9 million worth of options and long \$5</p> <p>8 million worth of options, the risk metric</p> <p>9 would not be triggered?</p> <p>10 MR. MOYLE: Object to form.</p> <p>11 A So you said short \$9 million,</p> <p>12 long \$5 million?</p> <p>13 Q Long \$5 million.</p> <p>14 A That would lead to a value in my</p> <p>15 matrix, again, this document is a draft,</p> <p>16 it's not well defined, of \$4 million.</p> <p>17 Q And does this risk metric as</p> <p>18 it's written differentiate between long and</p> <p>19 short exposure?</p> <p>20 A As I read it, it does not.</p> <p>21 Q The next --</p> <p>22 MR. SHANK: I've got a couple of</p> <p>23 questions about that.</p> <p>24 MR. WASSERMAN: Yes.</p> <p>25 MR. SHANK: That particular</p>

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1 Walczak
 2 metric was something that you came up
 3 with?
 4 THE WITNESS: Yes.
 5 MR. SHANK: How did you come up
 6 with eight percent of assets under
 7 management?
 8 THE WITNESS: So it goes back to
 9 the genesis of these metrics back in
 10 '07 when I experienced a very large
 11 drawdown and my desire was to restrict
 12 drawdowns to something in the single
 13 digits. And so if -- using an
 14 adjustment trigger and recognizing that
 15 even using an adjustment trigger is not
 16 a stop loss, it's not a go to cash,
 17 it's a signal to do something and so my
 18 somewhat arbitrary belief at the time
 19 was that by selecting an eight percent
 20 number, slippage, market conditions,
 21 whatever might go on in the real world
 22 in terms of making adjustments would
 23 allow me to restrict drawdowns to
 24 single digits or close.
 25 MR. SHANK: So this is based on

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1 Walczak
 2 the concept that, assuming you start
 3 with a net zero position, this metric
 4 would get triggered once you have had
 5 an eight percent drawdown effectively?
 6 Q This metric doesn't have
 7 anything to do with an eight percent
 8 drawdown, correct?
 9 A Correct.
 10 MR. WASSERMAN: The specific
 11 metric we are talking about is the net
 12 call or put value being less than eight
 13 percent of AUM.
 14 MR. SHANK: Right.
 15 But if you start at net zero,
 16 when you get to a point where your net
 17 short position is eight percent of AUM,
 18 you would have suffered approximately
 19 an eight percent drawdown in the fund?
 20 THE WITNESS: There is a
 21 relationship, but obviously, depending
 22 on when that happens, you know, if it
 23 happens over a period of three months,
 24 we take profits on other positions,
 25 maybe the fund has moved up and then it

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1 Walczak
 2 goes down, so it's really not quite
 3 that simple.
 4 Q And specifically, this metric
 5 tells you nothing about how the portfolio is
 6 going to perform under certain market
 7 conditions, correct?
 8 A Correct.
 9 MR. SHANK: Once you are at a
 10 net short position of eight percent,
 11 what does that mean for the future risk
 12 of the fund?
 13 THE WITNESS: Well, what it's
 14 designed to mean is that when the net
 15 premium gets to eight percent, that is
 16 suggestive of a higher level of risk
 17 for the fund. That's really why it's in
 18 the matrix.
 19 Q But there is a whole host of
 20 other things that would shed light on how
 21 the fund would perform in a specific
 22 environment, correct?
 23 A Exactly, in that --
 24 Q For example, how that \$8 million
 25 short position is going to perform depends

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1 Walczak
 2 on how close to the money it is, correct?
 3 A That's right.
 4 Q And how far away from expiry it
 5 is, correct?
 6 A There are a number of factors
 7 that influence --
 8 Q But none of those factors are
 9 reflected in that particular metric,
 10 correct?
 11 A No, there are no other factors
 12 in this metric and the reason for that and
 13 in all of these metrics is, this is a signal
 14 to do something and to your point, a whole
 15 host of portfolio attributes, market
 16 behavior, volatility behavior all have to be
 17 evaluated to be determine what it is that we
 18 need to do now that we've been triggered,
 19 that risk has been heightened because we
 20 have this eight percent open option premium.
 21 Q When you have a net short
 22 \$8 million position in a \$100 million
 23 portfolio, is there a limit to your losses,
 24 if that's your only position?
 25 A No.

<p style="text-align: right;">Page 121</p> <p>1 Walczak</p> <p>2 MR. SHANK: When you suffered</p> <p>3 your large drawdown in 2007 at Harbor</p> <p>4 Assets, prior to that drawdown, did you</p> <p>5 have a net short position greater than</p> <p>6 eight percent of AUM?</p> <p>7 THE WITNESS: I don't recall. I</p> <p>8 know it was larger afterwards.</p> <p>9 MR. SHANK: You don't recall</p> <p>10 whether you were above eight percent at</p> <p>11 the time?</p> <p>12 THE WITNESS: Right, I honestly</p> <p>13 don't.</p> <p>14 Q The fifth risk metric is labeled</p> <p>15 "Position Limits" and the metric</p> <p>16 specifically says, "Calls and put contracts</p> <p>17 independently three per \$40,000 AUM each,"</p> <p>18 is that a risk metric that you had come up</p> <p>19 with?</p> <p>20 A I didn't -- I'm not sure that's</p> <p>21 the exact risk metric. I did something like</p> <p>22 that.</p> <p>23 Q What specifically do you recall</p> <p>24 what you did?</p> <p>25 A I know that I had a specific</p>	<p style="text-align: right;">Page 123</p> <p>1 Walczak</p> <p>2 that short call as a risk position because</p> <p>3 it's the first position that's exposed to a</p> <p>4 market advance not covered by a long call</p> <p>5 below it. So that's a risk position</p> <p>6 definition.</p> <p>7 MR. WASSERMAN: Can you read</p> <p>8 that answer again?</p> <p>9 (Whereupon, the record was read</p> <p>10 as requested.)</p> <p>11 Q This metric as written in</p> <p>12 Exhibit 4, does not differentiate between</p> <p>13 covered and uncovered calls, correct?</p> <p>14 A No, it doesn't. In this</p> <p>15 document, no, it doesn't.</p> <p>16 Q The sixth metric --</p> <p>17 MR. SHANK: One question on</p> <p>18 that, is there a fixed position size</p> <p>19 when you talk about number of positions</p> <p>20 or can the size of the positions vary?</p> <p>21 THE WITNESS: Well, that's,</p> <p>22 again, when you talk about -- if you</p> <p>23 mean by position, you know, a spread,</p> <p>24 that's what we are trying to define</p> <p>25 here is not a spread or position so</p>
<p style="text-align: right;">Page 122</p> <p>1 Walczak</p> <p>2 numbers of positions per unit of capital</p> <p>3 metric.</p> <p>4 Q What did that tell you about</p> <p>5 your portfolio?</p> <p>6 A That would tell me how many</p> <p>7 positions -- how many units of risk I had</p> <p>8 for the given size of my portfolio.</p> <p>9 Q Specifically how did you define</p> <p>10 positions in this risk metric?</p> <p>11 A The way I define them and,</p> <p>12 again, it's different than how it's</p> <p>13 expressed here in this preliminary draft, I</p> <p>14 defined a risk position as, for a call, and</p> <p>15 the definition is different for calls and</p> <p>16 puts, for a call, any call that's not</p> <p>17 covered by a long call closer to the market.</p> <p>18 And that's an important distinction because</p> <p>19 if you have a credit spread, which we used</p> <p>20 at various points during our strategy, that</p> <p>21 would mean you are selling a call, say, if</p> <p>22 the market is at 2200, you sell a call at</p> <p>23 2300 and buy another call at 2350. Although</p> <p>24 your calls are -- you have the same number</p> <p>25 of shorts as you do longs, we would count</p>	<p style="text-align: right;">Page 124</p> <p>1 Walczak</p> <p>2 much as an individual contract. So it's</p> <p>3 the smallest common denominator unit of</p> <p>4 measure. This refers to a call contract</p> <p>5 and the definition tries to identify</p> <p>6 this -- it really, for risk purposes,</p> <p>7 doesn't matter if it's part of a one by</p> <p>8 three or by itself or a one by one</p> <p>9 spread, it's simply a call contract</p> <p>10 that's not covered below it by a long</p> <p>11 call contract.</p> <p>12 MR. SHANK: And by that, what I</p> <p>13 mean is, does it distinguish in any way</p> <p>14 from, say, having a hundred long and</p> <p>15 300 short versus a thousand long and</p> <p>16 3,000 short?</p> <p>17 THE WITNESS: Right, because</p> <p>18 that's -- you have more contracts.</p> <p>19 MR. SHANK: So it's measured by</p> <p>20 contracts rather than --</p> <p>21 THE WITNESS: Yes, lowest common</p> <p>22 denominator, a single contract.</p> <p>23 Q The sixth risk metric is</p> <p>24 "Maximum drawdown, five percent in one week,</p> <p>25 eight percent in one month." Is that a risk</p>

<p style="text-align: right;">Page 125</p> <p>1 Walczak</p> <p>2 metric that you came up with?</p> <p>3 A It's not one that I used</p> <p>4 preconversion.</p> <p>5 Q Is it one that you had come up</p> <p>6 with?</p> <p>7 A Yes, again, in collaboration</p> <p>8 with George. This was something -- some of</p> <p>9 the metrics that I mentioned I used prior,</p> <p>10 some I did not. This was one I did not use</p> <p>11 prior, but in collaboration with Catalyst,</p> <p>12 we agreed to it.</p> <p>13 Q The seventh is gamma risk, "The</p> <p>14 fund is not to exceed a short to long</p> <p>15 options position ratio of one to one," what</p> <p>16 does that mean to you?</p> <p>17 A The first thing I'll say is that</p> <p>18 I -- this item is misquoted, I believe, or</p> <p>19 not written correctly against a metric that</p> <p>20 I did use.</p> <p>21 Q What's incorrect about it?</p> <p>22 A The long to short option</p> <p>23 position ratio is a metric I use for put</p> <p>24 options exclusively.</p> <p>25 Q So you never used the risk</p>	<p style="text-align: right;">Page 127</p> <p>1 Walczak</p> <p>2 calls.</p> <p>3 MR. SHANK: So if I understand</p> <p>4 correctly, does that ensure that you</p> <p>5 never have any naked puts on in the</p> <p>6 portfolio?</p> <p>7 THE WITNESS: That's correct,</p> <p>8 that's the intent.</p> <p>9 MR. SHANK: To follow-up on the</p> <p>10 maximum drawdown, so that was something</p> <p>11 that you did not use prior to George's</p> <p>12 involvement?</p> <p>13 THE WITNESS: That's correct, I</p> <p>14 did not.</p> <p>15 MR. SHANK: Did you implement</p> <p>16 that at some point?</p> <p>17 THE WITNESS: The final version</p> <p>18 has those types of metrics in it. The</p> <p>19 top of my head, the final version and</p> <p>20 through some adjustments, I don't know</p> <p>21 if it was exactly five or eight, but</p> <p>22 that kind of metric is in there.</p> <p>23 MR. SHANK: When was the final</p> <p>24 version published?</p> <p>25 THE WITNESS: The risk metrics</p>
<p style="text-align: right;">Page 126</p> <p>1 Walczak</p> <p>2 metric as it's defined in this document?</p> <p>3 A No.</p> <p>4 Q What does long to short option</p> <p>5 position ratio have to do with gamma?</p> <p>6 A Nothing.</p> <p>7 Q Is this a metric that you came</p> <p>8 up with as written in this document?</p> <p>9 A Not as written in this document,</p> <p>10 no.</p> <p>11 Q Is there an analogous metric</p> <p>12 that you did come up with?</p> <p>13 A Yes, the metric I came up with</p> <p>14 was -- I don't remember how it's exactly</p> <p>15 stated, but the put option -- the ratio of</p> <p>16 short puts to long puts -- let me make sure</p> <p>17 I get this terminology right, so I'm not</p> <p>18 backwards. So the ratio of long puts to</p> <p>19 short puts must be greater than or equal to</p> <p>20 one.</p> <p>21 Q Was there any similar metric</p> <p>22 that you used relating to the ratio of call</p> <p>23 options in the portfolio?</p> <p>24 A No, the call metric was, as we</p> <p>25 talked about, simply looking at uncovered</p>	<p style="text-align: right;">Page 128</p> <p>1 Walczak</p> <p>2 have been dynamic over time. They</p> <p>3 haven't been changed every week, but</p> <p>4 they have been changed a couple of</p> <p>5 times since we put them in place</p> <p>6 formally.</p> <p>7 MR. SHANK: When was the first</p> <p>8 time there was a formal risk metric</p> <p>9 guideline put into place?</p> <p>10 THE WITNESS: Yes, that I don't</p> <p>11 know.</p> <p>12 MR. SHANK: You don't know?</p> <p>13 THE WITNESS: No.</p> <p>14 MR. SHANK: And prior to a</p> <p>15 formal guideline being put in place</p> <p>16 with George, did you have any formal</p> <p>17 guidelines that were implemented?</p> <p>18 THE WITNESS: The guidelines I</p> <p>19 used were the ones I developed in '07.</p> <p>20 Again, as a sole proprietor, so to</p> <p>21 speak, I didn't report them to anyone,</p> <p>22 I didn't really keep records, I simply</p> <p>23 had the guidelines in place and</p> <p>24 followed them.</p> <p>25 MR. SHANK: How did you go about</p>

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1 Walczak
2 ensuring that the maximum drawdown was
3 not breached?

4 THE WITNESS: Well, again, this
5 is really not intended to be a maximum
6 drawdown, that's -- this is intended to
7 measure volatility in the fund. And
8 it's also not an objective, it's a
9 trigger for us to say, wow, we have
10 just moved five percent in a week, for
11 example, taking this number, we better
12 examine the fund and identify what
13 action may need to be taken
14 (indicating).

15 MR. SHANK: So it's not a hard
16 rule that you need to limit losses to
17 that amount?

18 THE WITNESS: Oh, no, definitely
19 not.

20 MR. SHANK: It's a trigger to
21 have a conversation?

22 THE WITNESS: Yes.

23 Q So there were no metrics in
24 place to actually try to prevent an eight
25 percent drawdown from occurring?

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1 Walczak

2 MR. MOYLE: Object to the form
3 of the question.

4 A I mean, as a normal part of
5 operating the fund, one of my objectives is
6 to minimize drawdowns and if -- I mean, if
7 there were something that -- I mean, the
8 whole risk matrix is designed to alert us to
9 actions that we should consider to do just
10 that, but there is no stop loss or hard
11 number that we go after.

12 Q In 2014, 2015, 2016, was there
13 any risk metric in place that was
14 specifically targeted at limiting the size
15 of a drawdown?

16 MR. MOYLE: Object to the form
17 of the question. I'll tell you why I'm
18 objecting because of the phrase "risk
19 metric." When you use "risk metrics,"
20 are we talking about risk parameters
21 like these or are you using the phrase
22 differently, risk metric versus risk
23 parameters?

24 Q Did you have any procedures in
25 place as the portfolio manager in 2014, 2015

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1 Walczak

2 or 2016 that specifically tried to limit the
3 size of any drawdown?

4 A So, as I mentioned, in 2007, the
5 risk metric that I came up with was designed
6 to limit -- my goal was to limit the
7 drawdown to a single digit. So I put factors
8 in place based on my experience and based on
9 analytics of that drawdown that I felt would
10 help me limit the drawdown.

11 Q But which one of these specific
12 metrics or which one of any metric that you
13 used was specifically targeted at limiting a
14 drawdown to a single digit?

15 MR. MOYLE: Same objection.

16 A All of the parameters were
17 targeted in concert. In other words --

18 Q How were any of these parameters
19 specifically started at limiting drawdowns
20 to single digits?

21 A When I looked at the source of
22 the drawdown in 2007, I identified position
23 size as a contributor, volatility as a
24 contributor, identified margin usage as a
25 contributor. So I took the things that I

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1 Walczak

2 felt had contributed to the large drawdown
3 and quantified each of them and put a
4 parameter in place that said if any of these
5 reach a certain level, then that has to
6 alert me to take some action. And in
7 concert, if any of these parameters reach
8 this sort of critical level or important
9 level, then that alerts me to take action.
10 And the net result of any of them or all of
11 them triggering would ideally help limit a
12 drawdown.

13 Q Does any one of these risk
14 metrics shed any light in how the portfolio
15 is going to perform if the market goes up?

16 MR. MOYLE: Same objection.

17 A None of the metrics are designed
18 to presuppose or anticipate a market
19 condition. They are simply attributes of the
20 portfolio that in my analysis and experience
21 alert me to the need to take some sort of
22 action.

23 Q So none of these metrics
24 specifically sheds any light on how the
25 portfolio is going to perform if the market

<p style="text-align: right;">Page 133</p> <p>1 Walczak</p> <p>2 moves in a particular direction?</p> <p>3 MR. MOYLE: Same objection.</p> <p>4 A I mean, I guess I have to give</p> <p>5 the same response to the same question.</p> <p>6 Q Which is?</p> <p>7 A Which is, none of these risk</p> <p>8 parameters presupposes any market condition</p> <p>9 or future market behavior. It simply informs</p> <p>10 me that there is a condition present that</p> <p>11 requires attention with the goal of limiting</p> <p>12 drawdowns.</p> <p>13 MR. SHANK: Do any of the</p> <p>14 parameters listed on this Exhibit 4</p> <p>15 place hard limits on the positions you</p> <p>16 can take in managing the fund?</p> <p>17 THE WITNESS: In terms of</p> <p>18 numbers, again, this is not well stated</p> <p>19 here, but there is an equivalent</p> <p>20 metric. In terms of hard numbers,</p> <p>21 really the answer is yes, we are</p> <p>22 limited to the number of exposed risk</p> <p>23 position that we can take.</p> <p>24 MR. SHANK: You are referring to</p> <p>25 number five, position limits?</p>	<p style="text-align: right;">Page 135</p> <p>1 Walczak</p> <p>2 Q Aside from those, in 2014, 2015,</p> <p>3 2016, were you using any other risk metrics?</p> <p>4 A Well, there is a whole variety</p> <p>5 of things I look at in routine management of</p> <p>6 the portfolio and certainly I access --</p> <p>7 assess the risk characteristics of</p> <p>8 individual position, I assess the risk</p> <p>9 characteristics of options expiration</p> <p>10 periods specifically. So a lot of different</p> <p>11 things on the suite of things I look at to</p> <p>12 manage the portfolio.</p> <p>13 Q What do you mean when you say</p> <p>14 you look at risk characteristics of</p> <p>15 individual positions?</p> <p>16 A That means if I put on a one by</p> <p>17 three -- I mean, from experience, I know</p> <p>18 what it looks like, but I can tell specific</p> <p>19 strikes, specific volatility, specific</p> <p>20 months. I can tell where, you know, whether</p> <p>21 that position is preferable to a one by two</p> <p>22 or some other structure relative to what I</p> <p>23 have in the portfolio.</p> <p>24 Q What else do you do? What other</p> <p>25 risk metrics do you use?</p>
<p style="text-align: right;">Page 134</p> <p>1 Walczak</p> <p>2 THE WITNESS: Yes.</p> <p>3 MR. SHANK: Are there any other</p> <p>4 parameters that are hard limits on the</p> <p>5 position you can take?</p> <p>6 THE WITNESS: No.</p> <p>7 MR. SHANK: Okay.</p> <p>8 MR. WASSERMAN: We can go off</p> <p>9 the record.</p> <p>10 (Whereupon, a luncheon recess</p> <p>11 was taken.)</p> <p>12 AFTERNOON SESSION</p> <p>13 BY MR. WASSERMAN:</p> <p>14 Q Mr. Walczak, prior to our break,</p> <p>15 we talked about certain risk metrics</p> <p>16 outlined in Exhibit 4 and risk metrics that</p> <p>17 you used and came up with independently,</p> <p>18 some of which overlap with each other,</p> <p>19 correct?</p> <p>20 A Correct.</p> <p>21 Q We discussed specifically margin</p> <p>22 ratios, net option value, position limits</p> <p>23 and maximum drawdowns that would trigger</p> <p>24 those metrics, correct?</p> <p>25 A That's what's on this page, yes.</p>	<p style="text-align: right;">Page 136</p> <p>1 Walczak</p> <p>2 A Well, risk metrics per se,</p> <p>3 again, we have got a lot of risk parameters</p> <p>4 here and I think there is another more</p> <p>5 formal list, in fact, I know there is, that</p> <p>6 this was the antecedent for. So, again, it's</p> <p>7 just a wide variety of stuff that I look at.</p> <p>8 Q Does the more formal list you</p> <p>9 are referring to include metrics other than</p> <p>10 the ones listed here?</p> <p>11 A They do.</p> <p>12 Q Which ones specifically?</p> <p>13 A I don't recall that.</p> <p>14 Q Do you know when that formal</p> <p>15 risk metric list was put into place?</p> <p>16 A No, I don't recall that.</p> <p>17 Q In 2016, are you the one who's</p> <p>18 actually making the calculations in</p> <p>19 connection with the risk metrics?</p> <p>20 A Not me personally for sure in</p> <p>21 2016 and I'm trying to recall who exactly</p> <p>22 was doing the calculation. I'm not sure who.</p> <p>23 Q So in 2016 you are not</p> <p>24 personally monitoring, for example, the</p> <p>25 possible limits risk metric?</p>

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1 Walczak
2 A I'm monitoring it, I'm not doing
3 the calculation.
4 Q How do you monitor it?
5 A I look at the report that comes
6 out every morning.
7 Q When did you start getting a
8 report every morning?
9 A I don't recall that.
10 Q What was the report that you
11 started getting?
12 A The best I can recall is the
13 formal risk report that was the final
14 version of something like this at the time
15 (indicating).
16 MR. WASSERMAN: If we could mark
17 this document Exhibit 5.
18 (Photocopy of risk guidelines,
19 dated April 1, 2016 was marked
20 Commission Exhibit 5 for
21 identification, as of this date.)
22 Q This is a document Bates stamped
23 Catalyst 003 52514. Mr. Walczak, do you
24 recognize this document?
25 A Yes.

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1 Walczak
2 Q What it is?
3 A This looks to me to be the final
4 version of the risk metrics or risk
5 parameters that we use.
6 Q And is this a report that you
7 started getting every day?
8 A Yes.
9 Q And at what point do you recall
10 starting to get this report every day?
11 A I don't recall that exactly.
12 Q Was it prior to 2017?
13 A Yes.
14 Q Prior to 2016?
15 A I'm not sure.
16 Q Prior to the drawdown that the
17 fund had in early December?
18 A Yes.
19 Q Do you recall how long you had
20 been getting this type of report for prior
21 to the December drawdown?
22 A No.
23 Q If you could take a moment to
24 review the document.
25 A Sure.

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1 Walczak
2 Q Were you actually, were you
3 calculating any of the metrics reflected on
4 this spreadsheet?
5 A No.
6 Q Do you know who was calculating
7 them?
8 A No, I don't.
9 Q Do you know whether Mr. Amrhein
10 was calculating them?
11 A I'm really not certain.
12 Q Did you have an intern working
13 for you in or around mid 2016?
14 A Yes.
15 Q Who was the intern?
16 A We have had three different
17 interns during that time frame or roughly
18 during that time frame, at least that I can
19 recall. We had a number of them.
20 Q Do you know whether one of the
21 responsibilities of the intern is to
22 calculate these risk metrics?
23 A There was a point in time at
24 which some of these risk metrics were
25 reported by either my associate, Kimberly

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1 Walczak
2 Rios, or the intern, but I'm not sure
3 whether George supplemented this or not.
4 Q In 2016, are you using the
5 Option View tool?
6 A Yes.
7 Q How are you using it?
8 A Well, it depends on exactly what
9 we needed to do, but generally speaking the
10 tool is used to evaluate different
11 positions, which one should we use, where
12 should we put it, identify individual
13 options volatilities, compare them to other
14 individual options volatilities. A whole
15 plethora of all the things that we do to
16 manage our options positions in our
17 portfolio.
18 Q How do you use the Option View
19 tool to decide which positions to put on?
20 A First of all, we go back to our
21 analytics that I've mentioned about the term
22 structure of volatility. Once that generally
23 points us toward an expiration month, we
24 will then load some potential positions, and
25 again, we are also looking at the

<p style="text-align: right;">Page 141</p> <p>1 Walczak</p> <p>2 technicals, the fundamentals, the place in</p> <p>3 which we think we want to put positions. We</p> <p>4 will then go into Option View, we will look</p> <p>5 at where we think we want to go with a</p> <p>6 position and then evaluate individual</p> <p>7 options or evaluate putting the position on</p> <p>8 and model what it looks like, how it</p> <p>9 behaves.</p> <p>10 Q So you can put a hypothetical</p> <p>11 position into Option View and Option View</p> <p>12 does what?</p> <p>13 A It will give us a graph of that</p> <p>14 position value over time subject to certain</p> <p>15 parameters that we can adjust.</p> <p>16 Q Subject to what type of</p> <p>17 parameters?</p> <p>18 A Options Greeks, delta, gamma,</p> <p>19 vega, theta, different time frames.</p> <p>20 Q We have talked about delta, vega</p> <p>21 and theta, I believe, can you explain what</p> <p>22 gamma is?</p> <p>23 A Gamma is the first derivative of</p> <p>24 delta.</p> <p>25 Q So it's how quickly the delta</p>	<p style="text-align: right;">Page 143</p> <p>1 Walczak</p> <p>2 when don't use deltas. When I talk about a</p> <p>3 market neutral strategy, as I have been</p> <p>4 describing, we enter positions based on</p> <p>5 volatility. Once we enter those positions,</p> <p>6 market movement, the entering of the</p> <p>7 positions give, in fact, they obviously do</p> <p>8 give us a particular delta that's not an</p> <p>9 input to what we do. When I say market</p> <p>10 neutral, we are not delta neutral, we are</p> <p>11 not looking at the market and positioning</p> <p>12 every day trying to get to neutral.</p> <p>13 Q What would delta neutral mean?</p> <p>14 A Delta of zero.</p> <p>15 Q Meaning that the -- what does a</p> <p>16 delta of zero mean?</p> <p>17 A It means that, and this, I</p> <p>18 think, illustrates how delta can be not</p> <p>19 meaningful in many scenarios. A delta</p> <p>20 neutral position, if delta is zero, that</p> <p>21 would suggest that the position will not</p> <p>22 move if the market moves, the value of the</p> <p>23 position will not change if the market</p> <p>24 moves.</p> <p>25 Q So the portfolio is completely</p>
<p style="text-align: right;">Page 142</p> <p>1 Walczak</p> <p>2 changes over a given time period?</p> <p>3 A Yes.</p> <p>4 Q What else, if anything, does</p> <p>5 Option View tell or to clarify, does Option</p> <p>6 View tell you how those individuals are</p> <p>7 going to perform given certain inputs?</p> <p>8 A It gives us a graphical</p> <p>9 representation of the value of either an</p> <p>10 individual option, a position, a collection</p> <p>11 of positions at different points in time,</p> <p>12 which we can set, and at different levels of</p> <p>13 any Greek we want to set, primarily</p> <p>14 volatility.</p> <p>15 Q Does Option View calculate the</p> <p>16 delta of a position?</p> <p>17 A It can. It does.</p> <p>18 Q Did you use it to calculate the</p> <p>19 delta of a position?</p> <p>20 A Well, fundamental things you</p> <p>21 should know about delta and it really</p> <p>22 relates to the strategy, I think it's</p> <p>23 important, we operate a market neutral</p> <p>24 strategy and, in fact, that's different from</p> <p>25 a delta neutral strategy. And my point is</p>	<p style="text-align: right;">Page 144</p> <p>1 Walczak</p> <p>2 insensitive to market movement?</p> <p>3 A Right, which is -- which in the</p> <p>4 real world cannot be, does not happen. So</p> <p>5 just let me finish the description because I</p> <p>6 think it sets a backdrop in answering your</p> <p>7 question about delta. We operate a market</p> <p>8 neutral strategy, not a delta neutral</p> <p>9 strategy. Nothing about what we do takes a</p> <p>10 perspective on market movement and I think</p> <p>11 that's important. We are not using any -- we</p> <p>12 are not using options to generate a</p> <p>13 directional bias in the market. We don't</p> <p>14 attempt to predict market direction, we</p> <p>15 don't use -- we don't really use any sort of</p> <p>16 predictions of what might happen in the</p> <p>17 market to enter positions.</p> <p>18 Q Mr. Walczak, didn't you testify</p> <p>19 before that you used bank estimates of where</p> <p>20 the market was going to go in order to</p> <p>21 decide what level of strikes to place your</p> <p>22 positions at?</p> <p>23 A Yes, I did.</p> <p>24 Q And those positions' profit or</p> <p>25 loss depends on whether those expectations</p>

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1 Walczak
 2 are fulfilled, correct?
 3 A The positions have the
 4 opportunity to profit under a variety of
 5 conditions. As I said, primarily we place
 6 them there with a short volatility
 7 perspective knowing that if the market goes
 8 nowhere, we will make money as volatility
 9 comes out of the position. Secondly we
 10 know that we will make money as time comes
 11 out of the position if the market goes
 12 nowhere and the placement of the position is
 13 just designed to if the market goes higher,
 14 and, again, we have no perspective on
 15 whether it will, if the market goes higher,
 16 we want to have an understanding of where it
 17 might go. So we are not placing these
 18 positions with a bias that says we think the
 19 market is going higher and we think it's
 20 going here and we place it. We place the
 21 positions to say we have no idea if the
 22 market is going higher or lower. If it goes
 23 higher, this is a reasonable place it might
 24 end up.
 25 Q The placement of your -- the

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1 Walczak
 2 strike prices at which you decide to buy and
 3 sell call options is dependent on where that
 4 market projection is, correct?
 5 A Yes.
 6 Q Did you, in 2016, use Option
 7 View at all to calculate delta?
 8 A I don't recall doing it, no.
 9 Q Is Option View capable of
 10 calculating delta given a particular
 11 portfolio of assets?
 12 A Yes.
 13 Q Is Option View capable of
 14 calculating theta given a particular
 15 portfolio of assets?
 16 A Yes.
 17 Q Did you ever use Option View to
 18 calculate theta for your portfolio of
 19 assets?
 20 A I observed the theta calculation
 21 in Option View.
 22 Q So you did use Option View to
 23 calculate a theta?
 24 A Option View does that, yes.
 25 Q And it did it for you?

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1 Walczak
 2 A Yes.
 3 Q Did you place any value on that
 4 theta calculation?
 5 A The way we use theta, as I
 6 mentioned before, we like to put on
 7 positions at, most of the time, at even
 8 money. When we start to accumulate long
 9 option value in a portfolio, then we will
 10 put them on at a credit. So we depend
 11 primarily on keeping the net option value
 12 close to zero as we are entering positions
 13 recognizing that theta, like a lot of the
 14 Greeks, depend on a whole lot of other
 15 factors in the market. So that if you see,
 16 similar to seeing a delta of zero, you know
 17 right away that that's not true, because as
 18 soon as the market moves, the portfolio
 19 value will change. We look at theta and we
 20 understand that if Option View says theta is
 21 \$1 million per day, tomorrow a day has
 22 passed and it's highly unlikely that
 23 \$1 million is the value that the portfolio
 24 gains from theta. So we depend on the
 25 knowledge that if we are putting on

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1 Walczak
 2 positions at a capital neutral or even
 3 capital negative, meaning taking in some
 4 money, then regardless of what the theta
 5 calculation says, we are not exposed to
 6 theta risk.
 7 Q Is that theta value important to
 8 you in assessing your portfolio?
 9 A It's not a major factor.
 10 Q Are there theta levels that
 11 would cause you to take -- that would raise
 12 red flags for you?
 13 A Theta positive, we'll take a
 14 look and it's not uncommon if we are --
 15 meaning theta negative, I should say,
 16 meaning we are losing money on time decay,
 17 that would cause me to at least take a look
 18 and see if I agree with the perspective. In
 19 other words, I'll look at other factors and
 20 try to identify whether that's true.
 21 Q Have you ever taken action in
 22 your portfolio based on what the theta of
 23 the portfolio is?
 24 A On occasion.
 25 Q On what occasions?

<p style="text-align: right;">Page 149</p> <p>1 Walczak</p> <p>2 A I don't remember specifically. I</p> <p>3 do remember that -- I can't tell you, no, I</p> <p>4 have never done it.</p> <p>5 Q What would be the circumstances</p> <p>6 under which you would do it?</p> <p>7 A Well, generally speaking, if I</p> <p>8 noticed a negative theta number in the</p> <p>9 calculation, I would look at specific</p> <p>10 positions and specific expiration months and</p> <p>11 identify whether or not what was the premium</p> <p>12 value in those positions, was it reasonable</p> <p>13 to expect that we were actually negative</p> <p>14 theta or is this again a Greek calculation</p> <p>15 that will change tomorrow. So under certain</p> <p>16 circumstances, I would look at some of those</p> <p>17 scenarios and decide to make an adjustment</p> <p>18 to the portfolio.</p> <p>19 Q What type of adjustment would</p> <p>20 you make?</p> <p>21 A It's a, again, really depends on</p> <p>22 the market circumstances at the time.</p> <p>23 Obviously I would be looking to do something</p> <p>24 that would help me from a theta standpoint,</p> <p>25 but there is such a wide variety of</p>	<p style="text-align: right;">Page 151</p> <p>1 Walczak</p> <p>2 to calculate vega for a particular</p> <p>3 portfolio?</p> <p>4 A Yes.</p> <p>5 Q Was this something that you</p> <p>6 regularly did?</p> <p>7 A Yes, we focus on the vega.</p> <p>8 Q How specifically do you focus on</p> <p>9 vega?</p> <p>10 A The two primary things that are</p> <p>11 important to us are that, when we look at</p> <p>12 our call positions, we want to be short vega</p> <p>13 and when we look at our put positions, we</p> <p>14 want to be long or neutral to vega, not</p> <p>15 short.</p> <p>16 Q So in 2016, it was your practice</p> <p>17 to input your portfolio into Option View and</p> <p>18 have it calculate theta; is that correct?</p> <p>19 I'm sorry, and have it calculate vega; is</p> <p>20 that correct?</p> <p>21 A Yes.</p> <p>22 Q How often would you do that?</p> <p>23 A Daily.</p> <p>24 Q What levels of vega did you</p> <p>25 consider appropriate for the portfolio?</p>
<p style="text-align: right;">Page 150</p> <p>1 Walczak</p> <p>2 alternatives available.</p> <p>3 Q Like what?</p> <p>4 A Like entering a new position at</p> <p>5 a credit instead of a even money, for</p> <p>6 example.</p> <p>7 Q What do you mean at a credit</p> <p>8 instead of even money?</p> <p>9 A Meaning taking in more money</p> <p>10 selling the short side of the option spreads</p> <p>11 than we spend on the long side.</p> <p>12 Q How does that address your theta</p> <p>13 risk?</p> <p>14 A Well, that puts -- again, if you</p> <p>15 take in money, then if all the options</p> <p>16 expire worthless, you clearly have no time</p> <p>17 decay or negative time decay.</p> <p>18 Q Does Option View allow you to</p> <p>19 calculate vega for a particular portfolio?</p> <p>20 A Yes.</p> <p>21 Q Have you ever used Option View</p> <p>22 to calculate vega for a particular</p> <p>23 portfolio?</p> <p>24 A Yes.</p> <p>25 Q Did you in 2016 use Option View</p>	<p style="text-align: right;">Page 152</p> <p>1 Walczak</p> <p>2 A Specific levels of vega we</p> <p>3 didn't monitor. We really don't look, again,</p> <p>4 at specific Greeks, we really look more</p> <p>5 directional, meaning are we positive or</p> <p>6 negative theta, are we positive or negative</p> <p>7 vega, but the absolute value is less</p> <p>8 important. What we generally do and, again,</p> <p>9 you know, it's a very complex thing that we</p> <p>10 are running here, so I have to be very</p> <p>11 general about answers because each time we</p> <p>12 look at something, market conditions are</p> <p>13 different, portfolio structure is different.</p> <p>14 So there is a whole number of things that</p> <p>15 could be done. But, for example, if we</p> <p>16 discover that we are -- somehow, I can't</p> <p>17 exactly imagine how it would happen, but</p> <p>18 somehow we flipped negative vega underneath</p> <p>19 the market, then I would immediately look</p> <p>20 for adjustments and structures to correct</p> <p>21 that, but I don't have a vega goal or a</p> <p>22 number that I look for.</p> <p>23 Q But you generally want it to be</p> <p>24 positive vega and not negative vega?</p> <p>25 A Below the market.</p>

<p style="text-align: right;">Page 153</p> <p>1 Walczak</p> <p>2 Q What about above the market?</p> <p>3 A Above the market, we want the</p> <p>4 opposite, we want it to always be negative</p> <p>5 vega.</p> <p>6 Q In your call ratio strategy,</p> <p>7 your goal is to have your vega be negative?</p> <p>8 A Yes.</p> <p>9 Q And specifically that means that</p> <p>10 for any volatility decrease in the market,</p> <p>11 your portfolio is going to go up?</p> <p>12 A Yes.</p> <p>13 Q And for any volatility increase</p> <p>14 in the market, your portfolio is going to go</p> <p>15 down in value?</p> <p>16 A Again, all else being equal.</p> <p>17 And the point of that comment is why we</p> <p>18 don't look at numerical Greeks. What we do</p> <p>19 is we look at the graphical portrayal of an</p> <p>20 options price and then we move the Greeks</p> <p>21 around to understand how they are -- its</p> <p>22 impact.</p> <p>23 Q I don't quite follow that. Can</p> <p>24 you explain what you mean?</p> <p>25 A Sure. So Option View has the</p>	<p style="text-align: right;">Page 155</p> <p>1 Walczak</p> <p>2 is, for the most part, meaningless</p> <p>3 because it's impacted by all the other</p> <p>4 Greeks. The option prices are impacted</p> <p>5 by other Greeks. And not only that, if</p> <p>6 everything stays constant, the market</p> <p>7 doesn't move and you change vega, it</p> <p>8 also changes delta and theta. So the</p> <p>9 interaction of these things is what's</p> <p>10 important to us rather than the</p> <p>11 absolute number.</p> <p>12 MR. SHANK: But wouldn't a very</p> <p>13 large delta or very large vega in</p> <p>14 either direction suggest a significant</p> <p>15 exposure to either the market or to</p> <p>16 volatility?</p> <p>17 THE WITNESS: A very large on</p> <p>18 either one of those could. Again, it's</p> <p>19 not something that I experienced in</p> <p>20 running the fund all these years, but</p> <p>21 it could.</p> <p>22 MR. SHANK: But didn't vega burn</p> <p>23 you in 2007?</p> <p>24 THE WITNESS: It did.</p> <p>25 MR. SHANK: Was it a meaningful</p>
<p style="text-align: right;">Page 154</p> <p>1 Walczak</p> <p>2 capability to portray on a graph over time</p> <p>3 the value of an option, a collection of</p> <p>4 options, et cetera and to allow us to look</p> <p>5 at different time frames, which has the</p> <p>6 impact of seeing what is theta doing to the</p> <p>7 portfolio and the ability to flex</p> <p>8 volatility. So we can say what happens if</p> <p>9 volatility goes up five points or down five</p> <p>10 points.</p> <p>11 Q Specifically how that would</p> <p>12 affect your portfolio?</p> <p>13 A Yes.</p> <p>14 MR. SHANK: Why didn't the</p> <p>15 magnitude of the Greek measurements</p> <p>16 matter to you?</p> <p>17 THE WITNESS: Why didn't they</p> <p>18 matter?</p> <p>19 MR. SHANK: Yes.</p> <p>20 THE WITNESS: Well, again,</p> <p>21 because in my delta example, I found</p> <p>22 that the complexity of a single option,</p> <p>23 let alone a collection of options and a</p> <p>24 collection of option spreads is such</p> <p>25 that each of the Greeks by themselves</p>	<p style="text-align: right;">Page 156</p> <p>1 Walczak</p> <p>2 vega exposure in 2007?</p> <p>3 THE WITNESS: The important part</p> <p>4 was it was a negative vega exposure and</p> <p>5 that's why my corrective action was</p> <p>6 don't be negative. The answer is not be</p> <p>7 only a little negative, it's don't be</p> <p>8 negative. It's an on or off switch.</p> <p>9 MR. SHANK: Doesn't the</p> <p>10 magnitude matter in addition to the</p> <p>11 direction?</p> <p>12 THE WITNESS: It can.</p> <p>13 MR. SHANK: For example, if you</p> <p>14 were just barely negative vega, your</p> <p>15 exposure to volatility would be quite</p> <p>16 limited, right?</p> <p>17 THE WITNESS: Well, again, the</p> <p>18 problem with that is, if you are barely</p> <p>19 negative vega, it's not unusual for a</p> <p>20 market decline to cause your vega to</p> <p>21 accelerate. I won't get into the first</p> <p>22 derivative of vega in terms of Greeks,</p> <p>23 but if you start with a negative vega</p> <p>24 and the market declines, you can go</p> <p>25 dramatically more negative on the way</p>

<p style="text-align: right;">Page 157</p> <p>1 Walczak</p> <p>2 down. Again, all the Greeks interact</p> <p>3 with one another, which is why it's, in</p> <p>4 my experience, it's hazardous to rely</p> <p>5 on the specific number of that Greek.</p> <p>6 Q Thinking about vega in</p> <p>7 isolation, though, a vega of negative two</p> <p>8 means that for every percentage volatility</p> <p>9 increase, the portfolio is going to decline</p> <p>10 two percent, correct?</p> <p>11 A I'm not certain of that.</p> <p>12 Q Well, but that's what the</p> <p>13 measurement is used for, right?</p> <p>14 A I honestly don't think it's that</p> <p>15 simple.</p> <p>16 Q Well, so how is it more</p> <p>17 complicated?</p> <p>18 A Well, it doesn't have a linear</p> <p>19 relationship. So I just don't think that's</p> <p>20 factually correct to say that if vega is up</p> <p>21 two, the portfolio is down two, that's not</p> <p>22 the relationship.</p> <p>23 Q What's the correct way to</p> <p>24 factually define vega?</p> <p>25 A Honestly, I can't quote that to</p>	<p style="text-align: right;">Page 159</p> <p>1 Walczak</p> <p>2 A I think I answered that before,</p> <p>3 but delta means the sensitivity at that</p> <p>4 moment in time, all else being equal,</p> <p>5 nothing changing, the sensitivity of an</p> <p>6 options price to a market move.</p> <p>7 Q And a higher delta means a</p> <p>8 higher sensitivity to a particular market</p> <p>9 movement, correct?</p> <p>10 A All else being equal, yes.</p> <p>11 MR. SHANK: Are you familiar</p> <p>12 with the concept of delta adjusted</p> <p>13 exposure?</p> <p>14 THE WITNESS: Yes. It's not</p> <p>15 something I have used, but I think I</p> <p>16 understand what it means.</p> <p>17 MR. SHANK: Can you explain what</p> <p>18 your understanding of it is?</p> <p>19 THE WITNESS: Okay, then I guess</p> <p>20 I maybe don't understand it. I don't</p> <p>21 understand it honestly well enough to</p> <p>22 explain it to anyone.</p> <p>23 MR. SHANK: Do you understand</p> <p>24 how it's calculated?</p> <p>25 THE WITNESS: No, that I</p>
<p style="text-align: right;">Page 158</p> <p>1 Walczak</p> <p>2 you. I have been using the software so long,</p> <p>3 I can't quote back to you the underlying</p> <p>4 equation.</p> <p>5 Q What is your understanding of</p> <p>6 what vega means?</p> <p>7 A It means sensitivity to</p> <p>8 volatility.</p> <p>9 Q And a low vega number means a</p> <p>10 relatively low sensitivity to volatility,</p> <p>11 correct?</p> <p>12 A If you define "low" --</p> <p>13 Q All other things be equal.</p> <p>14 A Right.</p> <p>15 Q A low vega indicates a</p> <p>16 relatively low sensitivity to volatility,</p> <p>17 correct?</p> <p>18 A Whatever "low" means.</p> <p>19 Q Is it correct that a higher vega</p> <p>20 means a higher sensitivity to a particular</p> <p>21 move in volatility?</p> <p>22 A Than a correspondingly lower</p> <p>23 vega, yes, it does.</p> <p>24 Q And what's your understanding of</p> <p>25 delta?</p>	<p style="text-align: right;">Page 160</p> <p>1 Walczak</p> <p>2 definitely don't know.</p> <p>3 MR. SHANK: Do you understand</p> <p>4 what it's attempting to do?</p> <p>5 THE WITNESS: I think so.</p> <p>6 MR. SHANK: What is it that you</p> <p>7 understand that it's attempting to do?</p> <p>8 THE WITNESS: Say the name of it</p> <p>9 again?</p> <p>10 MR. SHANK: Delta adjusted</p> <p>11 exposure.</p> <p>12 THE WITNESS: No, I'm sorry, I</p> <p>13 honestly don't know.</p> <p>14 MR. SHANK: Do you know whether</p> <p>15 a delta adjusted exposure is a metric</p> <p>16 regularly used by options traders to</p> <p>17 measure exposure of option positions?</p> <p>18 THE WITNESS: I know that delta</p> <p>19 is. Delta adjusted exposure, it's not</p> <p>20 something that I use or have ever used,</p> <p>21 so I'm just not familiar with it.</p> <p>22 Q Have you ever used a program</p> <p>23 called Model Alpha?</p> <p>24 A I haven't personally used it,</p> <p>25 but I get -- well, actually that's not true.</p>

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1 Walczak
 2 I do look at portfolio values on line
 3 through Model Alpha, yes.
 4 Q What do you mean by that?
 5 A Model Alpha will generate an
 6 intraday, you know, settlement price. It's
 7 an aggregator software. It basically takes
 8 data from different FCM's and aggregates it.
 9 Q And how have you used Model
 10 Alpha?
 11 A Personally all I have done with
 12 Model Alpha is, either at the end of the day
 13 or during the day, during the day is not
 14 especially reliable, but end of day to look
 15 at what the change in settlement price for
 16 all the different FCM's are aggregated
 17 across the portfolio.
 18 Q But for what asset, for your
 19 particular portfolio?
 20 A Yes.
 21 Q So you use Model Alpha to
 22 potentially calculate the value of your
 23 portfolio at the end of the day?
 24 A From time to time. That's not
 25 the primary tool that I use, that's simply

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1 Walczak
 2 our Gemini accounting report that comes out.
 3 But as a quick look, recognizing it's not
 4 always accurate, that's how I use it.
 5 Q When you say "not the primary
 6 tool," you mean not the primary tool for
 7 calculating the value of the portfolio?
 8 A Right.
 9 Q You mean there are other tools
 10 the company uses to calculate the value of
 11 the portfolio?
 12 A Like fund accounting by Gemini.
 13 Q Is there any other way in which
 14 you use Model Alpha?
 15 A Again, I don't personally use
 16 it, but I know that Model Alpha --
 17 Q I thought you just said that you
 18 use Model Alpha to roughly calculate your
 19 portfolio value; is that incorrect?
 20 A Right, no, that's correct, I
 21 click on a button and the value looks at me.
 22 That's the only way in which I actually
 23 interact with the software other than to
 24 read output from the software that someone
 25 hands to me.

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1 Walczak
 2 Q What output do you read from the
 3 software?
 4 A There's a number of reports that
 5 I don't look at every day and some that I
 6 do. There is the risk report we put onto
 7 Model Alpha, there are trade tickets that
 8 come from Model Alpha, there are reports on
 9 margin at the various FCM's, just off the
 10 top of my head to name a few.
 11 Q In 2016 prior to the December
 12 drawdown of the fund, what types of outputs
 13 did you look at through Model Alpha, if any?
 14 A I mean, I can't remember
 15 specific days or periods, what was I looking
 16 at. Like I said, I know what reports are
 17 available. I generally --
 18 Q But what reports were available
 19 to you through Model Alpha prior to the
 20 December drawdown?
 21 A Again, the time frame, I don't
 22 know. I know what I look at or I roughly
 23 know what reports are available today and I
 24 don't remember which of those were available
 25 or not available in advance of December.

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1 Walczak
 2 Q Do you recall using Model Alpha
 3 for any other -- any purpose other than --
 4 do you recall using Model Alpha prior to the
 5 December drawdown at all?
 6 A I'm pretty sure that I was using
 7 it prior to December, but like I said, I
 8 just don't remember specifically which
 9 reports I happened to be looking at.
 10 Q Do you recall using Model Alpha
 11 in any way to assess the risk in the
 12 portfolio prior to December of 2016?
 13 A If -- by assessing the risk,
 14 Model Alpha does generate a version of this
 15 report (indicating).
 16 Q Did this Model Alpha generate a
 17 version of this report that you are pointing
 18 to in Exhibit 5 prior to your December
 19 drawdown in 2016?
 20 A I believe it did, yes.
 21 Q Do you recall Model Alpha being
 22 used in any other way prior to the December
 23 drawdown in 2016?
 24 A As I mentioned, at various
 25 points we've been working for a long time

<p style="text-align: right;">Page 165</p> <p>1 Walczak</p> <p>2 with Model Alpha to try to automate against</p> <p>3 an aggregator software across multiple</p> <p>4 FCM's. So we have been working to put trade</p> <p>5 blotters on it, to put risk report on it, to</p> <p>6 put margin from FCM on it, to put a lot of</p> <p>7 information to save us the trouble of</p> <p>8 aggregating that information manually from</p> <p>9 each individual FCM statement. So along the</p> <p>10 way, sometimes there are reports I would</p> <p>11 look at, sometimes there are new reports</p> <p>12 generated, sometimes the reports are in beta</p> <p>13 form, et cetera.</p> <p>14 Q Can Model Alpha be used to</p> <p>15 calculate option Greeks for the portfolio?</p> <p>16 A If it can, and I don't know</p> <p>17 whether it can or not, I don't look it at</p> <p>18 for that reason.</p> <p>19 Q In 2016, did you ever calculate</p> <p>20 value at risk for the portfolio?</p> <p>21 A I did not.</p> <p>22 Q To your knowledge, did anyone</p> <p>23 calculate value at risk for the portfolio in</p> <p>24 2016?</p> <p>25 A The reason I'm hesitating, I</p>	<p style="text-align: right;">Page 167</p> <p>1 Walczak</p> <p>2 occurrence in the market.</p> <p>3 MR. SHANK: Why is that</p> <p>4 calculation not useful to what you do.</p> <p>5 THE WITNESS: Again, I have a</p> <p>6 limited understanding of value at risk,</p> <p>7 but I mean, I'm not sure how you would</p> <p>8 take a portfolio and perform the</p> <p>9 calculation in a meaningful way on an</p> <p>10 options portfolio.</p> <p>11 MR. SHANK: Couldn't you run</p> <p>12 various simulations based on</p> <p>13 probabilities to estimate potential</p> <p>14 results for your portfolio?</p> <p>15 THE WITNESS: Again, if that's a</p> <p>16 value at risk calculation, I'm not</p> <p>17 familiar with it.</p> <p>18 MR. SHANK: Did you do any other</p> <p>19 kind of calculations during 2016 to</p> <p>20 estimate the total potential loss</p> <p>21 exposure of your portfolio at any given</p> <p>22 time?</p> <p>23 THE WITNESS: Again, I'm not</p> <p>24 sure that's a meaningful calculation. I</p> <p>25 mean, I can answer the question</p>
<p style="text-align: right;">Page 166</p> <p>1 Walczak</p> <p>2 know it's done now and I don't recall</p> <p>3 exactly when someone at Catalyst may have</p> <p>4 started calculating it.</p> <p>5 Q Have you ever taken a value at</p> <p>6 risk number into account in making trading</p> <p>7 decisions in your portfolio?</p> <p>8 A I haven't because my</p> <p>9 understanding of the value at risk</p> <p>10 calculation is not -- it's not something</p> <p>11 that would be meaningful to our particular</p> <p>12 portfolio.</p> <p>13 MR. SHANK: Can you explain what</p> <p>14 you understand value at risk to be?</p> <p>15 THE WITNESS: My understanding</p> <p>16 of value at risk is that it attempts</p> <p>17 to, in a number of different ways,</p> <p>18 which gets back to difficult for our</p> <p>19 portfolio, but a number of different</p> <p>20 way or computational methods attempts</p> <p>21 to estimate what a -- what loss a</p> <p>22 portfolio might experience under a one</p> <p>23 in a hundred or one in 20 type of --</p> <p>24 some kind of rare, whatever the actual</p> <p>25 numbers are, some kind of rare</p>	<p style="text-align: right;">Page 168</p> <p>1 Walczak</p> <p>2 directly and say that I look at, you</p> <p>3 know, again, individual options</p> <p>4 positions, placement. I look at these</p> <p>5 risk parameters and again not just</p> <p>6 looking to say, wow, it hit a trigger</p> <p>7 I've got to do something, but just to</p> <p>8 identify, you know, what levels are we</p> <p>9 at, what is the potential risk in the</p> <p>10 portfolio because these are the things</p> <p>11 that I have depended on for a long</p> <p>12 period of time (indicating).</p> <p>13 Q For the record, you are pointing</p> <p>14 to the risk parameters in Exhibit 5?</p> <p>15 A Yes.</p> <p>16 MR. SHANK: So none of the risk</p> <p>17 parameters in Exhibit 5 attempt to</p> <p>18 estimate or calculate the potential</p> <p>19 risk exposure in the portfolio; is that</p> <p>20 right?</p> <p>21 THE WITNESS: Let me take</p> <p>22 another look before I answer the</p> <p>23 question. No, none of these are</p> <p>24 attempting to forecast what loss might</p> <p>25 happen under certain conditions.</p>

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1 Walczak
 2 MR. SHANK: So were you doing
 3 anything to attempt to estimate what
 4 your potential portfolio exposure was
 5 at any given time?
 6 THE WITNESS: Well, the way in
 7 which I think about portfolio exposure,
 8 and it gets, I think, back to value at
 9 risk is, we know, based on the type of
 10 options positions we put on, we know
 11 where our risk is, we know that losses
 12 will occur under certain conditions.
 13 And what I do is depend on these
 14 parameters to give me that signal that
 15 suggests we are getting close to a
 16 place or we are at a place where some
 17 action should be taken to avoid, again,
 18 the goal being a less than or a single
 19 digit drawdown. These tell me when
 20 action need to be taken, that's been my
 21 experience in operating this type of
 22 portfolio (indicating).
 23 Q Are you aware at any given point
 24 of the magnitude of the potential losses of
 25 your portfolio given a particular market

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1 Walczak
 2 movement?
 3 A When -- I mean, as I said, I
 4 know that if the market goes up five percent
 5 tomorrow, that we are exposed to large
 6 losses.
 7 Q But in 2016, you are sitting at
 8 your desk with a particular portfolio, the
 9 Hedged Futures Strategy Fund has a
 10 particular portfolio, are you aware of the
 11 magnitude of gains or losses given a
 12 particular market movement?
 13 A Over a particular time frame, we
 14 can project that and look at it.
 15 Q How do you project that?
 16 A We look at Option View's graph
 17 and say, look, here's where our -- you know,
 18 again, the thing to it is it's not new or
 19 especially meaningful in terms of I have
 20 confidence and have relied on these types of
 21 metrics to tell me when action needs to be
 22 taken.
 23 Q The metrics in Exhibit 5?
 24 A The metrics in Exhibit 5, so I'm
 25 not wanting to be responsive -- I mean,

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1 Walczak
 2 there is always a scenario where if the
 3 market is up five percent tomorrow, it's a
 4 large loss. My reaction to that cannot be to
 5 manage for tomorrow's possibility of a five
 6 percent loss. My reaction to that has to be
 7 to rely on the strategy as I have operated
 8 over the years, to rely on my risk triggers
 9 and to know that over a long period of time
 10 they have proven to be effective in limiting
 11 loss.
 12 Q I'm simply asking, in 2016, was
 13 it your practice to be aware of how much
 14 money the portfolio would gain or lose given
 15 a particular market movement the following
 16 day?
 17 A I did not focus on that metric.
 18 Q Was it your practice to be aware
 19 of how much money the portfolio would gain
 20 or lose given a particular market movement
 21 over the following week?
 22 A I looked at portfolio values
 23 across different time frames as I will
 24 always do, but, again, the answer is always
 25 the same, it's not telling me anything new.

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1 Walczak
 2 Q But are you aware of what the
 3 magnitude of the gains or losses would be
 4 given a particular market movement over a
 5 particular period of time?
 6 MR. SHANK: It's a yes or no
 7 question.
 8 A If I choose to look at that
 9 analysis, yes. It's not something that I
 10 look at every day.
 11 Q Do you recall looking at that
 12 analysis in 2016?
 13 A Somewhere in 2016 certainly I
 14 looked at it.
 15 Q And by that analysis, what type
 16 of analysis did you look at, do you recall
 17 looking at, sometime in 2016?
 18 A I would look at an Option View
 19 portfolio value graph.
 20 Q What would that tell you
 21 specifically?
 22 A It would tell me things about --
 23 and the context in which I would look at
 24 these would be on options expiration
 25 specific months because that would tell me

<p style="text-align: right;">Page 173</p> <p>1 Walczak</p> <p>2 how to manage the particular upcoming</p> <p>3 options expiration slice of the portfolio</p> <p>4 and that's typically how we managed the</p> <p>5 portfolio.</p> <p>6 Q What specifically would Option</p> <p>7 View tell you about the positions you had</p> <p>8 for that contract month?</p> <p>9 A It would tell me at various</p> <p>10 market levels, holding things equal, or on</p> <p>11 occasion -- more than on occasion, I would</p> <p>12 typically adjust parameters like volatility</p> <p>13 to understand the impact. I would look at a</p> <p>14 price level and what the risk or opportunity</p> <p>15 was around that price level, meaning if the</p> <p>16 market moved in one direction or the other,</p> <p>17 is that where I want it to be or do I need</p> <p>18 to make some adjustments.</p> <p>19 Q But would Option View</p> <p>20 specifically tell you for that particular</p> <p>21 expiry how much money the portfolio stood to</p> <p>22 gain or lose?</p> <p>23 A Yes, it would.</p> <p>24 Q And do you recall specifically</p> <p>25 using Option View to calculate the potential</p>	<p style="text-align: right;">Page 175</p> <p>1 Walczak</p> <p>2 you used Option View to make such</p> <p>3 calculations regarding exposure on a</p> <p>4 given option position.</p> <p>5 THE WITNESS: As often as</p> <p>6 needed.</p> <p>7 MR. SHANK: What does that mean,</p> <p>8 how frequently during the 2016 time</p> <p>9 period would you do it?</p> <p>10 THE WITNESS: So I'm using</p> <p>11 Option View on a daily basis primarily</p> <p>12 to evaluate new entry --</p> <p>13 Q Mr. Walczak, I'm sorry to</p> <p>14 interrupt, but I don't want you to have to</p> <p>15 be here longer than you need to.</p> <p>16 A Sure.</p> <p>17 Q The specific question is, how</p> <p>18 often do you recall using Option View in</p> <p>19 2016 for the purposes of evaluating</p> <p>20 potential gains and losses on a particular</p> <p>21 contract?</p> <p>22 MR. MOYLE: And since he</p> <p>23 interrupted your last answer, I think</p> <p>24 you need to be clear, give him the</p> <p>25 number that he's looking for, if you</p>
<p style="text-align: right;">Page 174</p> <p>1 Walczak</p> <p>2 gains or losses for your position in a</p> <p>3 particular contract month in 2016?</p> <p>4 A In 2016, certainly from time to</p> <p>5 time, I did that.</p> <p>6 Q How often?</p> <p>7 A A clarifying answer to that is</p> <p>8 I'm not managing the portfolio to say, you</p> <p>9 know, X gain or loss, I'm managing a profit</p> <p>10 region to understand how to manage the</p> <p>11 portfolio and when I'm leaving the region I</p> <p>12 want to be in, do I need to take some action</p> <p>13 that's subservient to this. These are the</p> <p>14 metrics that tell me when I need to take</p> <p>15 some action from a risk standpoint</p> <p>16 (indicating).</p> <p>17 Q "These" being the metrics in</p> <p>18 Exhibit 5?</p> <p>19 A Yes.</p> <p>20 Q I know it's --</p> <p>21 MR. SHANK: I don't think we got</p> <p>22 an answer on the last question --</p> <p>23 MR. WASSERMAN: That's what I</p> <p>24 was going to ask.</p> <p>25 MR. SHANK: -- of how frequently</p>	<p style="text-align: right;">Page 176</p> <p>1 Walczak</p> <p>2 know it. Or if you don't know, say you</p> <p>3 don't know.</p> <p>4 A I guess that's the point, I</p> <p>5 don't keep tick marks or track of I used,</p> <p>6 you know, X number of times did I use Option</p> <p>7 View to calculate portfolio value.</p> <p>8 MS. ALOISI: You said "from time</p> <p>9 to time," though, so what does that</p> <p>10 mean to you? How are we supposed to</p> <p>11 interpret that in terms of the</p> <p>12 frequency? You obviously have some</p> <p>13 sense of the frequency.</p> <p>14 MR. MOYLE: If that's the</p> <p>15 question you were answering when you</p> <p>16 were interrupted, go ahead and finish</p> <p>17 that answer.</p> <p>18 A From time to time would mean</p> <p>19 once a week, a couple times a month. It's a</p> <p>20 little bit like on average. Again, Option</p> <p>21 View is not the primary tool I'm using to</p> <p>22 understand the portfolio value. I'm really</p> <p>23 understanding the --</p> <p>24 Q Not the portfolio value, the</p> <p>25 potential change in portfolio value given a</p>

<p style="text-align: right;">Page 177</p> <p>1 Walczak</p> <p>2 movement in the market. Are you using it for</p> <p>3 that purpose?</p> <p>4 A Directionally.</p> <p>5 Q What does that mean?</p> <p>6 A That means that I can tell</p> <p>7 whether the portfolio is going to increase</p> <p>8 in value or decrease in value based on what</p> <p>9 volatility does, what price does.</p> <p>10 Q But are you paying attention to</p> <p>11 how much it would increase or decrease?</p> <p>12 A Yes, and typically in a</p> <p>13 particular options expiration period, yes.</p> <p>14 Q So at the risk of asking the</p> <p>15 same question again, how often would you use</p> <p>16 Option View to calculate the potential gains</p> <p>17 or losses of the portfolio's position on a</p> <p>18 particular contract month?</p> <p>19 A I don't have a routine that says</p> <p>20 I do it every day or I do it every week. I</p> <p>21 do it as needed.</p> <p>22 Q And as needed in 2016 meant what</p> <p>23 exactly?</p> <p>24 A Once a week, once every couple</p> <p>25 of days. Again, I don't know how to</p>	<p style="text-align: right;">Page 179</p> <p>1 Walczak</p> <p>2 exam staff?</p> <p>3 THE WITNESS: Yes.</p> <p>4 MR. SHANK: During that</p> <p>5 interview, did you tell the exam staff</p> <p>6 that you used Option View to examine</p> <p>7 individual positions, but not the</p> <p>8 portfolio as a whole?</p> <p>9 MR. MOYLE: I have to jump in</p> <p>10 here for a second. I don't think he's</p> <p>11 ever sat for an interview with the SEC</p> <p>12 exam staff.</p> <p>13 MR. SHANK: You did, didn't you?</p> <p>14 Weren't you interviewed by the SEC exam</p> <p>15 staff?</p> <p>16 THE WITNESS: I thought so.</p> <p>17 MR. ZILIAK: Exam?</p> <p>18 MR. MOYLE: I don't know if you</p> <p>19 are speaking of an open meeting that</p> <p>20 took place.</p> <p>21 MR. SHANK: I wasn't there, I'm</p> <p>22 not on the exam staff.</p> <p>23 MS. ALOISI: Why don't we let</p> <p>24 him testify about it.</p> <p>25 MR. SHANK: In June of 2017, did</p>
<p style="text-align: right;">Page 178</p> <p>1 Walczak</p> <p>2 characterize it.</p> <p>3 Q Did you ever use Option View to</p> <p>4 calculate the potential gains or losses of</p> <p>5 the entire portfolio, not simply the</p> <p>6 portfolio's position on a particular</p> <p>7 contract expiry?</p> <p>8 A Yes.</p> <p>9 Q How often did you do that in</p> <p>10 2016?</p> <p>11 A As needed. Again, I didn't have</p> <p>12 a structured routine, I didn't have rules or</p> <p>13 periodic -- it's a complex portfolio. There</p> <p>14 is subjectivity to adjustment and management</p> <p>15 of the existing positions, that's what --</p> <p>16 that's how my process works. So, again, I</p> <p>17 can't say that I come in every Tuesday</p> <p>18 morning and do it. I do it as needed. There</p> <p>19 are days that I know from experience that,</p> <p>20 no matter what is going on in the</p> <p>21 marketplace, there is no need to check</p> <p>22 portfolio values or anything else about the</p> <p>23 positions.</p> <p>24 MR. SHANK: In June of 2017, did</p> <p>25 you sit for an interview with the SEC</p>	<p style="text-align: right;">Page 180</p> <p>1 Walczak</p> <p>2 you meet with certain individuals of</p> <p>3 the SEC examination staff in connection</p> <p>4 with your management of the Catalyst</p> <p>5 funds?</p> <p>6 THE WITNESS: Yes.</p> <p>7 MR. SHANK: What was the</p> <p>8 structure of that meeting?</p> <p>9 THE WITNESS: From what I recall</p> <p>10 is the exam staff had questions about</p> <p>11 how various pieces of software,</p> <p>12 including primarily, I guess, Option</p> <p>13 View, were used in managing the</p> <p>14 portfolio and how they functioned.</p> <p>15 MR. SHANK: During that</p> <p>16 interview, did you walk the exam staff</p> <p>17 through how you used Option View?</p> <p>18 THE WITNESS: I walked them</p> <p>19 through all the different functionality</p> <p>20 and some of the things that I typically</p> <p>21 did when I used Option View, yes.</p> <p>22 MR. SHANK: During that meeting,</p> <p>23 did you tell the exam staff that you</p> <p>24 used Option View to examine individual</p> <p>25 positions, but not the portfolio as a</p>

<p style="text-align: right;">Page 181</p> <p>1 Walczak</p> <p>2 whole?</p> <p>3 THE WITNESS: I don't recall</p> <p>4 making that statement, but, again, I</p> <p>5 don't recall.</p> <p>6 MR. SHANK: So did you use</p> <p>7 Option View to evaluate the total risk</p> <p>8 of the portfolio as a whole rather than</p> <p>9 just individual positions?</p> <p>10 THE WITNESS: From time to time</p> <p>11 I did.</p> <p>12 MR. SHANK: Coming back to "from</p> <p>13 time to time," same answer as before,</p> <p>14 you are talking about maybe weekly,</p> <p>15 maybe a couple of times a month?</p> <p>16 THE WITNESS: Yes.</p> <p>17 MR. CAZAKOFF: What market</p> <p>18 factors would make you want to look at</p> <p>19 Option View to view the portfolio value</p> <p>20 or what changes in market factors?</p> <p>21 THE WITNESS: Primary the risk</p> <p>22 guidelines or, again, using a judgment</p> <p>23 about some event that may have</p> <p>24 occurred, a volatility spike.</p> <p>25 MR. SHANK: Can you take me</p>	<p style="text-align: right;">Page 183</p> <p>1 Walczak</p> <p>2 Catalyst 003 02301.</p> <p>3 MR. WASSERMAN: Can we mark this</p> <p>4 as Exhibit 6, please?</p> <p>5 (Photocopy of slide deck was</p> <p>6 marked Commission Exhibit 6 for</p> <p>7 identification, as of this date.)</p> <p>8 Q Mr. Walczak, if you could take a</p> <p>9 moment to flip through this document,</p> <p>10 please? Does this document look familiar to</p> <p>11 you?</p> <p>12 A Yes.</p> <p>13 Q What is it?</p> <p>14 A It's -- I believe it's a</p> <p>15 marketing piece or presentation on the</p> <p>16 strategy and how it operates.</p> <p>17 Q Specifically the strategy of the</p> <p>18 Hedged Futures Strategy Fund?</p> <p>19 A Correct.</p> <p>20 Q Can I turn your attention to</p> <p>21 page 11?</p> <p>22 MR. SHANK: Maybe I missed it,</p> <p>23 did you say who the audience was for</p> <p>24 this?</p> <p>25 THE WITNESS: No, I think it</p>
<p style="text-align: right;">Page 182</p> <p>1 Walczak</p> <p>2 through how you would go about</p> <p>3 evaluating the total loss exposure of</p> <p>4 your portfolio in Option View?</p> <p>5 THE WITNESS: Well, again, I'm</p> <p>6 not coming at it from a total loss</p> <p>7 exposure, I'm looking at portfolio</p> <p>8 value and how the portfolio value is</p> <p>9 impacted by passage of time,</p> <p>10 volatility, et cetera.</p> <p>11 MR. SHANK: But Mr. Wasserman's</p> <p>12 questions were specifically about your</p> <p>13 evaluation of the magnitude of</p> <p>14 potential loss in the portfolio as a</p> <p>15 whole. Did you use Option View to</p> <p>16 evaluate the potential magnitude of</p> <p>17 loss of the portfolio as a whole?</p> <p>18 THE WITNESS: No.</p> <p>19 MR. SHANK: Did you use any</p> <p>20 other tools to evaluate the potential</p> <p>21 magnitude of total loss for the</p> <p>22 portfolio?</p> <p>23 THE WITNESS: No.</p> <p>24 Q Mr. Walczak, I would like to put</p> <p>25 in front of you a document Bates stamped</p>	<p style="text-align: right;">Page 184</p> <p>1 Walczak</p> <p>2 says on here something about registered</p> <p>3 investment professionals only, but I</p> <p>4 don't have any understanding of where</p> <p>5 it was used.</p> <p>6 Q Do you recall whether this</p> <p>7 document was posted on the Catalyst website?</p> <p>8 A I don't know.</p> <p>9 Q Are you familiar with the</p> <p>10 Catalyst website?</p> <p>11 A Yes.</p> <p>12 Q Are you familiar with a page</p> <p>13 within the Catalyst website that allows</p> <p>14 anybody to view Catalyst publications?</p> <p>15 A Yes.</p> <p>16 Q Are you aware whether this type</p> <p>17 of presentation is made available on that</p> <p>18 website every quarter?</p> <p>19 A That I honestly don't know.</p> <p>20 Q Have you ever seen a</p> <p>21 presentation like this on the website?</p> <p>22 A No.</p> <p>23 Q If I could turn your attention</p> <p>24 to page 11?</p> <p>25 A Okay.</p>

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1 Walczak
2 Q There are three paragraphs on
3 that page, one that states a risk management
4 strategy. It states, "A risk management
5 strategy explicitly focused on limiting
6 losses by hedging individual positions at
7 initiation." Is this an accurate statement?
8 A Yes, we do hedge individual
9 positions at initiation.
10 Q How do you hedge individual
11 positions at initiation?
12 A We have a combination of
13 offsetting positions, so long and short
14 positions. So the short positions, which
15 represent the risk, are offset in some way
16 by the long positions.
17 Q In the call ratio strategy, you
18 described the strategy at least in the past
19 couple of years being a buy one call, sell
20 three call strategy, correct?
21 A Correct.
22 Q So is that position hedged at
23 initiation?
24 A It is. The long call acts as a
25 hedge on the risk of the short calls.

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1 Walczak
2 Q What are the potential losses in
3 that position?
4 A Theoretically the potential
5 losses are unlimited.
6 Q Are the two remaining short
7 calls hedged in any way?
8 A The spread structure itself is a
9 single position, so we treat it as such, so
10 it has a hedge component and a risk
11 component.
12 Q And as we discussed earlier, if
13 the long and short calls are 50 points
14 apart, once you get 25 points above your
15 short call, the position starts to lose
16 money, correct?
17 A Correct.
18 Q And as the market continues to
19 go up, do those losses ever mitigate in that
20 particular position?
21 A Not without corrective action on
22 our part, no.
23 Q If I could turn your attention
24 to page eight, could you take a moment to
25 read the second bullet? Specifically where

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1 Walczak
2 it says, "We use a specific set of rules and
3 tactics focused on limiting losses." By the
4 way, were you involved at all in drafting
5 this presentation?
6 A Yes, I was.
7 Q Did you draft it?
8 A I provided parts of the dialogue
9 to it.
10 Q Which parts do you recall
11 providing?
12 A I'm not certain which exact
13 parts.
14 Q Do you recall providing the
15 parts about risk management?
16 A Yes, I provided these.
17 Q Who did you provide them to?
18 A I'm trying to recall who was
19 putting this document together.
20 Q This is from Q3 or it states Q3
21 2016.
22 A Yes, I think Kimberly Rios and I
23 jointly worked on this.
24 Q Did anyone else work on it?
25 A I'm not certain if anyone at

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1 Walczak
2 Catalyst worked on it after we submitted it
3 to them.
4 Q To whom did you submit it?
5 A I don't recall exactly.
6 Q Somebody at Catalyst?
7 A Yes.
8 Q Was it Jerry Szilagyi?
9 A I don't know. I didn't
10 personally submit it.
11 Q Who personally submitted it, to
12 your knowledge?
13 A It likely would have been
14 Kimberly.
15 Q This bullet point I'm referring
16 to that starts, "The fund employs a distinct
17 risk management strategy," is that something
18 that you specifically recall drafting?
19 A Yes.
20 Q When you are stating, "We use a
21 specific set of rules and tactics focused on
22 limiting losses," what specific rules and
23 tactics are you referring to?
24 A So that's meant to describe
25 the -- all of the things that I do in

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1 Walczak
2 selecting positions, in identifying which
3 positions are the right ones to use or more
4 favorable ones to use at the time. It
5 incorporates our overall risk metrics
6 (indicating).

7 Q For the record, you just lifted
8 up Exhibit 5. You have to pretend she
9 doesn't see anything.

10 A Oh, all right. So back to the
11 question.

12 Q What, quote, specific set of
13 rules and tactics focused on limiting
14 losses, end quote, do you use?

15 A So the bullets here reflect some
16 of those tactics, perhaps all of them, but
17 the specific rules and tactics are things
18 like we optimize position sizing, meaning we
19 don't put on too many positions. We enter
20 trades not all at once, but over time,
21 scaling, which diversifies the risk of a
22 single bad trade. We enter trades in
23 different strike prices and expiration
24 periods, which, again, diversifies the risk
25 of a single bad trade. Dynamic hedging of

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1 Walczak
2 option structures, to your point about
3 unlimited risk, that the call hedge in the
4 position we put on hedges risk to a point
5 when -- one of our dynamic hedging is that
6 we will often buy hedge calls to further
7 hedge the risk when the situation requires
8 it. Limiting overall risk refers to the
9 metrics we have in place that trigger
10 actions.

11 Q Which metrics did you have in
12 place to limit overall risk?

13 A The entirety of the risk
14 parameters signal that action is necessary
15 to --

16 Q Which specific risk parameter
17 was targeted toward limiting overall risk?

18 A There is not a specific risk
19 parameter. There is a whole collection of
20 risk parameters --

21 Q Which specific parameter was
22 focused on limiting overall losses?

23 A Again, there is no specific
24 parameter that acts as a stop loss or a loss
25 limitation. We can't tell people that there

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1 Walczak
2 is a guaranteed limit to loss.

3 Q Well, you said in this document
4 that you are limiting overall risk and
5 limiting overall loss and that you have
6 specific rules and tactics focused on
7 limiting losses. I'm asking, what are those
8 specific rules and tactics?

9 A Right. So I have described some
10 of the things I use on a daily basis in our
11 our positions are constructed and then I'm
12 referring to Exhibit 5, the collection of
13 risk parameters that signal us to take
14 action when action is appropriate and the
15 goal is to limit loss and limit risk.

16 Q Which one of these parameters in
17 Exhibit 5 actually limits loss?

18 A There isn't a single parameter
19 that limits loss. The functioning of the
20 risk parameters as a collective signal or
21 signals to take action has the effect, the
22 goal and in my experience, the effect of
23 limiting loss.

24 Q But the measurement of total
25 option premium value doesn't tell you

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1 Walczak
2 anything about potential losses, correct?

3 A It doesn't quantify the losses,
4 no.

5 Q And the number of position
6 limits doesn't tell you anything about
7 potential losses, correct?

8 A It does not quantify the extent
9 of loss, no.

10 Q It doesn't tell you what the
11 magnitude of your losses could be, correct?

12 A That's correct.

13 Q None of these metrics tell you
14 what the magnitude of your losses could be,
15 correct?

16 A Correct.

17 Q So how does any one of these
18 risk metrics limit loss if none of them is
19 telling you what the magnitude of the losses
20 could be?

21 MR. MOYLE: Objection. You have
22 asked him this five times, he's
23 answered it five times and I don't
24 think it's fair for you to continue
25 asking him hoping that he's going to

<p style="text-align: right;">Page 193</p> <p>1 Walczak</p> <p>2 say something different. He's answered</p> <p>3 the question.</p> <p>4 MR. WASSERMAN: I'm asking for a</p> <p>5 truthful answer to the question.</p> <p>6 MR. MOYLE: You are getting a</p> <p>7 truthful answer to the question, you</p> <p>8 get don't like the answer, Sam.</p> <p>9 Q If none of these metrics tell</p> <p>10 you anything about the potential magnitude</p> <p>11 of the losses, how does any of them tell you</p> <p>12 anything about limiting loss?</p> <p>13 MR. MOYLE: Same objection.</p> <p>14 A In our document that says we are</p> <p>15 limiting loss, we also don't quantify what</p> <p>16 that loss is, we just say that we have</p> <p>17 tactics and rules in place to limit loss.</p> <p>18 And what I'm referring to is how we</p> <p>19 structure our positions and the risk metrics</p> <p>20 or risk parameters, sorry, that we have in</p> <p>21 Exhibit 5 that signal action, that, in turn,</p> <p>22 leads to a limiting of loss.</p> <p>23 MS. ALOISI: So would it be your</p> <p>24 testimony that if you reduce the</p> <p>25 potential loss from a hundred percent</p>	<p style="text-align: right;">Page 195</p> <p>1 Walczak</p> <p>2 limit would be -- would be 240,000 of</p> <p>3 contracts that were not covered?</p> <p>4 THE WITNESS: At the risk of</p> <p>5 doing math in public, I think that is</p> <p>6 correct.</p> <p>7 MR. SHANK: It was four billion</p> <p>8 divided by a million is 4,000, right?</p> <p>9 THE WITNESS: Yes.</p> <p>10 MR. SHANK: 4,000 times 60 is</p> <p>11 240,000.</p> <p>12 THE WITNESS: That was the hard</p> <p>13 part.</p> <p>14 MR. SHANK: Does that sound</p> <p>15 right?</p> <p>16 THE WITNESS: Yes.</p> <p>17 MR. SHANK: So the limit you put</p> <p>18 in place regarding positions was you</p> <p>19 could have 240,000 uncovered call</p> <p>20 contracts in place, right?</p> <p>21 THE WITNESS: Correct.</p> <p>22 MR. SHANK: Did you ever do</p> <p>23 anything to attempt to quantify what</p> <p>24 kind of exposure 240,000 contracts</p> <p>25 could be to the portfolio?</p>
<p style="text-align: right;">Page 194</p> <p>1 Walczak</p> <p>2 to 99 percent, then this is a truthful</p> <p>3 statement because you've limited</p> <p>4 potential loss?</p> <p>5 THE WITNESS: It would,</p> <p>6 technically speaking, be a truthful</p> <p>7 statement, yes.</p> <p>8 MR. SHANK: So your limits on</p> <p>9 positions, what was the limit again</p> <p>10 that ultimately got implemented and was</p> <p>11 in effect in 2016?</p> <p>12 MR. MOYLE: Which one again?</p> <p>13 MR. SHANK: The limit on number</p> <p>14 of positions.</p> <p>15 THE WITNESS: I'm looking at</p> <p>16 Exhibit 5, which is April 1st, and it</p> <p>17 is 60 positions per million.</p> <p>18 Q Per million of assets under</p> <p>19 management?</p> <p>20 A Yes.</p> <p>21 MR. SHANK: So the fund had</p> <p>22 about four billion under management in</p> <p>23 late 2016; is that right?</p> <p>24 THE WITNESS: Yes.</p> <p>25 MR. SHANK: So the position</p>	<p style="text-align: right;">Page 196</p> <p>1 Walczak</p> <p>2 THE WITNESS: I don't recall</p> <p>3 doing that calculation.</p> <p>4 MR. SHANK: So how can you come</p> <p>5 up with that limit, the 60 per million?</p> <p>6 THE WITNESS: Both of the limits</p> <p>7 were based on the position sizing that</p> <p>8 was in place in '07 and significantly</p> <p>9 reducing that position sizing and these</p> <p>10 are limits, again, that carried across</p> <p>11 ten years of market conditions. And</p> <p>12 while we can certainly talk about, wow,</p> <p>13 that sounds like a really big number,</p> <p>14 we went through a lot of market</p> <p>15 conditions and it's not a target</p> <p>16 either, it's something we operate</p> <p>17 significantly lower than most of the</p> <p>18 time, this is simply meant to make sure</p> <p>19 that under some kind of unusual</p> <p>20 circumstance we don't get too high. So</p> <p>21 it's really an experienced-based, as is</p> <p>22 much of the strategy, an</p> <p>23 experience-based strategy.</p> <p>24 MR. SHANK: And that limit in no</p> <p>25 way limits the value of those</p>

<p style="text-align: right;">Page 197</p> <p>1 Walczak</p> <p>2 particular shorts, right?</p> <p>3 THE WITNESS: Correct, that's</p> <p>4 the other parameter that talks about</p> <p>5 eight percent.</p> <p>6 MR. SHANK: So under the</p> <p>7 position limit, you could effectively</p> <p>8 have 240,000 in the money short calls</p> <p>9 that did not have a long position</p> <p>10 covering it; is that right?</p> <p>11 THE WITNESS: Without doing the</p> <p>12 math, I would expect you could not have</p> <p>13 240,000 short calls in the money</p> <p>14 without dramatically exceeding the</p> <p>15 eight percent value of those calls.</p> <p>16 MR. SHANK: But that individual</p> <p>17 parameter wouldn't limit you from doing</p> <p>18 that, correct?</p> <p>19 THE WITNESS: Correct.</p> <p>20 MR. SHANK: And the eight</p> <p>21 percent of NAV was not a hard rule,</p> <p>22 correct, there was nothing forcing you</p> <p>23 to sell and not bridge that goal?</p> <p>24 THE WITNESS: Well, all of the</p> <p>25 risk parameters have a metric that says</p>	<p style="text-align: right;">Page 199</p> <p>1 Walczak</p> <p>2 directional or delta-based. Traditional</p> <p>3 risk metrics like value at risk don't</p> <p>4 have a strong predictive value in terms</p> <p>5 of calling something to action. We know</p> <p>6 where the risk is and we use a set of</p> <p>7 risk metrics that allow us to get early</p> <p>8 warning or appropriate warning that</p> <p>9 action may be required and that's how</p> <p>10 we managed over ten or 11 years of</p> <p>11 market conditions, managed it</p> <p>12 successfully.</p> <p>13 MR. SHANK: I asked you before</p> <p>14 whether you ever attempted to quantify</p> <p>15 the potential exposure from that</p> <p>16 position limit, did you ever attempt to</p> <p>17 quantify the amount of exposure to the</p> <p>18 fund of being short eight percent of</p> <p>19 NAV?</p> <p>20 THE WITNESS: No.</p> <p>21 Q Mr. Walczak, do you communicate</p> <p>22 about the fund with people outside of</p> <p>23 Catalyst?</p> <p>24 A Yes.</p> <p>25 Q Who do you communicate with</p>
<p style="text-align: right;">Page 198</p> <p>1 Walczak</p> <p>2 you should look and take action. In</p> <p>3 fact, I think we have got it on here</p> <p>4 that says we need to do something when</p> <p>5 that happens.</p> <p>6 MR. SHANK: Right, but I think</p> <p>7 you said before that that meant before</p> <p>8 a conversation that considered taking</p> <p>9 action rather than require action; is</p> <p>10 that right?</p> <p>11 THE WITNESS: The corrective</p> <p>12 action on our risk parameter says</p> <p>13 reduces the value within 24 hours.</p> <p>14 MR. MOYLE: I think he's talking</p> <p>15 about the other eight percent NAV.</p> <p>16 THE WITNESS: Well, I was</p> <p>17 referring, when I was talking about the</p> <p>18 240,000 calls, I was referring -- you</p> <p>19 say you could have 240,000 in the money</p> <p>20 calls, I can't imagine that you could</p> <p>21 have that and still not have far</p> <p>22 exceeded a long time ago your eight</p> <p>23 percent rule. I guess the real point</p> <p>24 behind this is this is, again, it's a</p> <p>25 market neutral strategy, it's not</p>	<p style="text-align: right;">Page 200</p> <p>1 Walczak</p> <p>2 outside of Catalyst?</p> <p>3 A Particularly the way our</p> <p>4 distribution cycle works is Catalyst</p> <p>5 wholesalers, salespeople will contact</p> <p>6 financial advisers and present information</p> <p>7 on the fund. It's not uncommon with a</p> <p>8 complex derivative strategy like this that</p> <p>9 the salesperson is unable to answer the</p> <p>10 adviser's questions. In that situation, they</p> <p>11 would typically ask for a phone call with me</p> <p>12 to go a little bit deeper into how the</p> <p>13 strategy works. So that was a typical -- a</p> <p>14 phone call with a financial adviser set up</p> <p>15 by the salesperson would typically be my</p> <p>16 interaction outside the company.</p> <p>17 Q Can you tell us a little more</p> <p>18 about the typical financial adviser that</p> <p>19 deals with Catalyst?</p> <p>20 A I don't have a sense for exactly</p> <p>21 really how to characterize financial</p> <p>22 advisers, other than I know that these guys</p> <p>23 are fairly sophisticated guys that often</p> <p>24 have discretionary authority over client</p> <p>25 money and are, you know, typical -- one of</p>

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1 Walczak
 2 the skills they bring to the party is to
 3 understand a portfolio composition, to
 4 understand -- and that's the point of
 5 explaining the strategy, understanding where
 6 a strategy like this might fit into a
 7 client's portfolio and risk tolerance.
 8 That's what I know about financial advisers.
 9 Q Do you recall in 2016
 10 representing to any financial advisers that
 11 you had a goal of limiting fund losses to
 12 eight percent of AUM?
 13 A I can't speak to any individual
 14 calls because there were a lot of them. I
 15 can tell you that the typical call did not
 16 include a discussion of risk management. On
 17 occasion, because -- on occasion, advisers
 18 would inquire about risk management and I
 19 told them the same story that I've told here
 20 today, that I put risk management in place,
 21 we have modified it in -- in 2007, we have
 22 modified it to some extent over time. We now
 23 use it, there is oversight at Catalyst level
 24 and when I put it in place and it continues
 25 to be a goal of a single digit drawdown,

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1 Walczak
 2 that there is no -- and I refer them to the
 3 risk statement and to the performance
 4 record, which includes periods where we
 5 didn't hold a drawdown to ten percent, but I
 6 said that's our goal, single digit.
 7 Q Specifically do you recall
 8 telling advisers that the goal was to limit
 9 a drawdown to eight percent?
 10 A No. The eight percent reference
 11 is always used to refer to the two
 12 volatility -- I'm sorry, the two risk
 13 parameters that talk about volatility
 14 excursion of eight percent and at the time,
 15 we modified, but at the time an eight
 16 percent open option premium number. So by
 17 setting those eight percent goals, and it's
 18 the same narrative that I have delivered
 19 here today, by setting those eight percent
 20 goals on those parameters, we hoped that we
 21 could achieve a single digit drawdown.
 22 MR. WASSERMAN: Can I mark this
 23 as Exhibit 7.
 24 (Photocopy of email chain, dated
 25 January 2, 2017, was marked Commission

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1 Walczak
 2 Exhibit 7 for identification, as of
 3 this date.)
 4 Q Mr. Walczak, this is a document
 5 Bates stamped Catalyst 003 001923, if you
 6 could take a moment to review this document.
 7 A Sure.
 8 Q And for clarity, there is text
 9 on the back of the page although it appears
 10 to be some signature blocks.
 11 A Okay.
 12 Q Do you recognize this document?
 13 A I do.
 14 Q What is it?
 15 A It's an email that I wrote to
 16 one of our wholesalers.
 17 Q Is Brandon Schwulst a
 18 wholesaler?
 19 A Yes.
 20 Q Kimberly, you mentioned, is your
 21 assistant portfolio manager; is that
 22 correct?
 23 A Correct.
 24 Q The document is dated January 2,
 25 2017. Does this document refresh your

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1 Walczak
 2 recollection as to whether you have
 3 represented that your goal is to limit
 4 downside to eight percent?
 5 MR. MOYLE: Object to the form
 6 of the question.
 7 A So what the document says is, "I
 8 wish I could provide a rock solid max
 9 drawdown, but obviously I can't guarantee
 10 anything," and it says, "As we always have a
 11 goal to limit downside to eight percent
 12 daily noise notwithstanding," again, to my
 13 point that we are trying to keep it to
 14 single digit, we use eight percent numbers
 15 knowing that there could be slippage beyond
 16 that.
 17 Q But as represented in this
 18 document, your goal -- you've stated that
 19 your goal is to limit drawdowns to eight
 20 percent?
 21 A Yes, that's what was stated
 22 here, however, the eight percent number is
 23 done with a mindset that we know there can
 24 be, under different market conditions, they
 25 could certainly, in fact, expect slippage.

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1 Walczak
 2 So by setting a goal of our eight percent,
 3 our real-world achievable objective is
 4 single digit.
 5 Q Are you suggesting that you only
 6 start to actually do anything about limiting
 7 risk after the fund has already lost eight
 8 percent?
 9 A No, that eight percent
 10 volatility parameter is one of the things
 11 that calls us to action.
 12 Q But you mentioned "slippage,"
 13 what do you mean by slippage?
 14 A So when we get a risk parameter
 15 that suggests we have to take action, market
 16 conditions may dilute the action we take
 17 and when we get a trigger at eight percent
 18 or any of these other parameters, it may not
 19 be possible. In fact, that's what I state,
 20 it's not possible to put an immediate halt
 21 to the decline.
 22 Q Right. So as I understand it,
 23 the metric doesn't require you to do
 24 anything until after you've had the eight
 25 percent drawdown, correct?

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1 Walczak
 2 A That particular --
 3 Q In Exhibit 5?
 4 A In Exhibit 5, that particular
 5 metric and, by the way, refers to an eight
 6 percent drawdown -- I'll leave it at that,
 7 it refers to an eight percent drawdown as
 8 one of the metrics that would cause us to
 9 take action.
 10 Q To be clear, the metric itself
 11 in Exhibit 5 doesn't require you to do
 12 anything before you've already lost eight
 13 percent?
 14 A That single metric does not, but
 15 there are others that do.
 16 Q This email suggests something
 17 slightly different, does it not?
 18 Specifically that your goal is to limit
 19 downside to eight percent as opposed to
 20 start to try to limit downside after you've
 21 already lost eight percent?
 22 A I don't think this changes our
 23 goal.
 24 Q Are you stating in this email
 25 that your goal is to limit downside to eight

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1 Walczak
 2 percent?
 3 A "Daily noise notwithstanding,"
 4 that's correct.
 5 Q That's different than waiting
 6 until you've lost eight percent and then
 7 trying to do something, correct?
 8 A On that particular metric, we
 9 could be at an eight percent drawdown before
 10 we take action.
 11 Q I'm asking about what you said
 12 in this email.
 13 A Right.
 14 Q The statement, "A goal to limit
 15 downside to eight percent" is different than
 16 waiting until you've lost eight percent and
 17 then trying to limit downside?
 18 A And our goal to limit it to
 19 eight percent is affected by the entirety of
 20 the risk parameters, not by a single metric.
 21 So I would argue or I would dispute --
 22 Q Is that clear from your email?
 23 A Let me finish for a moment. I
 24 would dispute the answer that that's the
 25 only metric that's driving the train, it's a

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1 Walczak
 2 single metric.
 3 Q I understand that point. I'm
 4 asking whether your statement in this
 5 particular email suggests that you are doing
 6 things prior to actually losing eight
 7 percent to try to limit the drawdown to
 8 eight percent?
 9 A And in my experience, that would
 10 typically be the case.
 11 MR. SHANK: What metric would
 12 you expect to be triggered before you
 13 got to an eight percent loss?
 14 THE WITNESS: In my experience,
 15 the most common metric that triggers is
 16 the open call premium.
 17 MR. SHANK: The open -- say that
 18 again?
 19 THE WITNESS: The open call
 20 premium of eight percent.
 21 MR. SHANK: The eight percent of
 22 NAV?
 23 THE WITNESS: Yes.
 24 MR. MOYLE: He said the eight
 25 percent of NAV?

<p style="text-align: right;">Page 209</p> <p>1 Walczak</p> <p>2 THE WITNESS: Yes, eight percent</p> <p>3 is a percentage of assets in the fund</p> <p>4 open call, if that's what -- to be</p> <p>5 clear, that's what NAV or you could</p> <p>6 call it AUM. And we should be clear on</p> <p>7 that because there is a volatility</p> <p>8 number in here that Sam has been</p> <p>9 referring to is an eight percent</p> <p>10 drawdown in NAV, that call premium</p> <p>11 number is eight percent open call</p> <p>12 premium as a percentage of assets.</p> <p>13 MR. SHANK: That's net call</p> <p>14 premium?</p> <p>15 THE WITNESS: Yes.</p> <p>16 Q Does the open option premium</p> <p>17 metric tell you anything about the</p> <p>18 portfolio's sensitivity to market movement?</p> <p>19 A No.</p> <p>20 Q Does the open option premium</p> <p>21 metric tell you anything about the magnitude</p> <p>22 of potential losses?</p> <p>23 A What the open option premium</p> <p>24 tells us is that the combination of market</p> <p>25 movement, volatility movement, time decay,</p>	<p style="text-align: right;">Page 211</p> <p>1 Walczak</p> <p>2 you about your portfolio's sensitivity to</p> <p>3 market movement.</p> <p>4 A It doesn't tell us anything</p> <p>5 about sensitivity to market movement.</p> <p>6 MR. SHANK: In your email in</p> <p>7 Exhibit 7, you wrote "D-E-C," that's</p> <p>8 the third line in your email, "D-E-C</p> <p>9 printed roughly a four percent drawdown</p> <p>10 and we are currently down a little over</p> <p>11 six percent from our high-water mark."</p> <p>12 Do you see that?</p> <p>13 THE WITNESS: Yes.</p> <p>14 MR. SHANK: Does "D-E-C" mean</p> <p>15 December?</p> <p>16 THE WITNESS: Yes.</p> <p>17 MR. SHANK: So you said, "These</p> <p>18 numbers are well within the norm of our</p> <p>19 11-year track record." So was a four</p> <p>20 percent drawdown in one month well</p> <p>21 within the norm of what you've</p> <p>22 historically seen happen with your</p> <p>23 strategy?</p> <p>24 THE WITNESS: Yes.</p> <p>25 MR. SHANK: What would you</p>
<p style="text-align: right;">Page 210</p> <p>1 Walczak</p> <p>2 Greeks have created a situation where we</p> <p>3 should take action to prevent large losses.</p> <p>4 Q I believe you testified before</p> <p>5 that the open option premium collection</p> <p>6 looks solely at the market value of your</p> <p>7 options positions, correct?</p> <p>8 A Yes.</p> <p>9 Q What does the market value of</p> <p>10 your options positions tell you, if</p> <p>11 anything, about the sensitivity of your</p> <p>12 portfolio to market movement?</p> <p>13 A What it tells us is that some</p> <p>14 combination, not a single metric that</p> <p>15 changes on a daily basis or may or may not</p> <p>16 be relevant, but the overall market</p> <p>17 condition, be it passage of time, be it</p> <p>18 volatility, be it market movement of the</p> <p>19 underlying or other Greek factors, that</p> <p>20 tells us that that has created a situation</p> <p>21 where there is risk in the portfolio that we</p> <p>22 have to address.</p> <p>23 Q Mr. Walczak, respectfully, you</p> <p>24 are not answering my question. I'm asking</p> <p>25 what the market value of your options tells</p>	<p style="text-align: right;">Page 212</p> <p>1 Walczak</p> <p>2 describe as the norm, the limit of the</p> <p>3 norm for drawdowns in a month using</p> <p>4 your strategy?</p> <p>5 THE WITNESS: Well, we have the</p> <p>6 statistics on largest drawdown, which</p> <p>7 was February of '07. My recollection is</p> <p>8 that we have several other high single</p> <p>9 digit drawdowns and one at least that</p> <p>10 was slightly into double digits as</p> <p>11 well, but, again, that's a top of my</p> <p>12 head recollection.</p> <p>13 MR. SHANK: Can we go back to</p> <p>14 Exhibit 6 for a minute?</p> <p>15 MR. WASSERMAN: The</p> <p>16 presentation.</p> <p>17 MR. SHANK: Page 2303 under,</p> <p>18 "Fund Objective," it says, "To preserve</p> <p>19 capital and provide consistent returns</p> <p>20 with low volatility regardless of</p> <p>21 market direction by investing in long</p> <p>22 and short option positions on the S&P</p> <p>23 500 Index," do you agree that that's</p> <p>24 what the fund's objective was?</p> <p>25 THE WITNESS: Yes.</p>

<p style="text-align: right;">Page 213</p> <p>1 Walczak</p> <p>2 MR. SHANK: Do you consider</p> <p>3 single month drawdowns of high single</p> <p>4 digits percent to be consistent with</p> <p>5 preservation of capital?</p> <p>6 THE WITNESS: I do and the</p> <p>7 reason I answer that way is because,</p> <p>8 two things, we are attempting to</p> <p>9 preserve capital across a reasonable</p> <p>10 investment time horizon, so there will</p> <p>11 be some volatility in the fund on a</p> <p>12 monthly basis. Secondly, the fund</p> <p>13 has consistently exhibited far lower</p> <p>14 drawdowns in even its underlying index</p> <p>15 across even in a short time frame as a</p> <p>16 month. So capital preservation is</p> <p>17 certainly our objective and there is</p> <p>18 nothing in the historical record that</p> <p>19 suggests to me that that's</p> <p>20 inappropriate.</p> <p>21 MR. SHANK: I think you</p> <p>22 described within the range of norm high</p> <p>23 single digit drawdowns in a month; is</p> <p>24 that correct?</p> <p>25 THE WITNESS: Correct.</p>	<p style="text-align: right;">Page 215</p> <p>1 Walczak</p> <p>2 to you?</p> <p>3 THE WITNESS: It meant that by</p> <p>4 operating my strategy consistently as I</p> <p>5 have had in the past, the strategy</p> <p>6 would generate a return stream that,</p> <p>7 when looked at across a normal time</p> <p>8 horizon, that was relatively low</p> <p>9 volatility.</p> <p>10 MR. SHANK: What's a normal time</p> <p>11 horizon?</p> <p>12 THE WITNESS: Well, across the</p> <p>13 life of the fund.</p> <p>14 MR. SHANK: So when you are</p> <p>15 saying low volatility, you mean over</p> <p>16 multiple years?</p> <p>17 THE WITNESS: That's a</p> <p>18 reasonable time frame, sure.</p> <p>19 MR. SHANK: So it might have</p> <p>20 high volatility within -- year to year?</p> <p>21 THE WITNESS: I think for any</p> <p>22 investment strategy, including an asset</p> <p>23 index fund, you can select a time frame</p> <p>24 and say, wow, it was really volatile</p> <p>25 here and I can particular a time frame</p>
<p style="text-align: right;">Page 214</p> <p>1 Walczak</p> <p>2 MR. SHANK: What about on the</p> <p>3 upside, what's within the norm of your</p> <p>4 upside in a given month?</p> <p>5 THE WITNESS: Off the top of my</p> <p>6 head, one percent, two percent.</p> <p>7 Sometimes there have been periods of</p> <p>8 time where -- we had a 20 percent month</p> <p>9 in '08. It's basically volatility</p> <p>10 dependent, so...</p> <p>11 MR. SHANK: There were times</p> <p>12 that you had up to 20 percent you said,</p> <p>13 right?</p> <p>14 THE WITNESS: Right.</p> <p>15 MR. SHANK: Do you consider from</p> <p>16 high single digit negative returns to</p> <p>17 20 percent positive returns to be low</p> <p>18 volatility?</p> <p>19 THE WITNESS: Again, you know, I</p> <p>20 can't comment on what's low volatility,</p> <p>21 high volatility. It doesn't immediately</p> <p>22 strike me as not low volatility.</p> <p>23 MR. SHANK: Well, as the</p> <p>24 portfolio manager, what did low</p> <p>25 volatility in the fund objective mean</p>	<p style="text-align: right;">Page 216</p> <p>1 Walczak</p> <p>2 and say it was really low over here. So</p> <p>3 to me, you want to look at as long a</p> <p>4 time frame as you can, which in this</p> <p>5 case would be the life of the fund.</p> <p>6 MR. SHANK: Have you ever seen</p> <p>7 an equity index fund claim to be a low</p> <p>8 volatility investment?</p> <p>9 THE WITNESS: I'm not familiar</p> <p>10 with their prospectuses.</p> <p>11 MR. SHANK: Your goal as</p> <p>12 portfolio manager wasn't to necessarily</p> <p>13 manage low volatility within a given --</p> <p>14 from year to year?</p> <p>15 THE WITNESS: Well, my goal is</p> <p>16 to execute the fund objective,</p> <p>17 absolutely, and in my experience, the</p> <p>18 methodology, tactics, instruments we</p> <p>19 used produced a relatively low volatile</p> <p>20 performance record.</p> <p>21 MR. SHANK: Relative to what?</p> <p>22 THE WITNESS: Relative to its</p> <p>23 underlying.</p> <p>24 MR. SHANK: What's its</p> <p>25 underlying?</p>

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1 Walczak
 2 THE WITNESS: The S&P 500.
 3 MR. SHANK: Do you think the S&P
 4 500 is the appropriate benchmark for
 5 your fund?
 6 THE WITNESS: It is in the sense
 7 that that's the underlying instrument
 8 that the options we trade are -- that's
 9 the underlying for our options. It
 10 also -- we know from how the fund is
 11 used that it's typically a component of
 12 an equity portfolio, so the S&P 500 is
 13 certainly an appropriate index from
 14 that standpoint.
 15 Q Mr. Walczak, would you
 16 acknowledge that there is a difference
 17 between targeting a maximum drawdown of
 18 eight percent and taking precautions after
 19 the fund has lost eight percent?
 20 A Again, you know, I am very
 21 reluctant to go outside the framework and
 22 focus on an individual number and say, wow,
 23 we are only taking action when the fund is
 24 down eight percent.
 25 Q I'm just asking the question in

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1 Walczak
 2 isolation. There is a difference between
 3 targeting a maximum drawdown of X and only
 4 doing something to limit losses after you've
 5 lost X, correct?
 6 A If that's your only criteria, I
 7 would say that's correct.
 8 Q I'm simply asking if there is a
 9 difference between those two statements?
 10 A There certainly can be, but,
 11 again, there could also be a circumstance
 12 where if you had an individual security that
 13 had a good tight liquidity and you say I
 14 have my stop loss at eight percent, then
 15 there is no difference in that.
 16 Q I'm asking a simple question. Is
 17 there a difference between telling somebody
 18 that you are trying to limit losses to eight
 19 percent on the one hand and telling somebody
 20 that once you lose eight percent, then you
 21 will try to limit losses?
 22 A There is a difference. I can say
 23 that I have never heard those differences
 24 expressed in the same situation or in the
 25 same conversation.

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1 Walczak
 2 Q But you acknowledge that there
 3 is a difference?
 4 A There is a difference.
 5 Q Because in the latter scenario
 6 you are not really trying to limit losses to
 7 eight percent, you are only trying to limit
 8 losses after eight percent, correct?
 9 A No, I disagree. An eight percent
 10 stop loss in an individual security may very
 11 well be the way to limit losses to eight
 12 percent.
 13 Q In an individual security that's
 14 liquid that you can guarantee that you are
 15 going to be able to execute at a particular
 16 point in time, correct?
 17 A That's one example.
 18 Q Do you recall specifically
 19 telling investment advisers that your goal
 20 was to limit losses in the fund to eight
 21 percent?
 22 A Yes. Yes, I do.
 23 Q Do you recall saying that to
 24 investment advisers on multiple occasions?
 25 A Certainly more than once.

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1 Walczak
 2 MR. WASSERMAN: Should we take a
 3 five-minute break?
 4 MR. SHANK: Can I ask one more
 5 question about Exhibit 6?
 6 MR. WASSERMAN: Sure.
 7 MR. SHANK: Page six, are you
 8 familiar with this chart?
 9 THE WITNESS: Yes.
 10 MR. SHANK: Does this reflect
 11 the daily investment process for your
 12 management of the fund?
 13 THE WITNESS: Let me take a look
 14 to make sure it does describe that.
 15 Yes.
 16 MR. SHANK: So the first step on
 17 a daily basis before making investments
 18 is to stress the fund --
 19 THE WITNESS: I'm sorry, I'm
 20 looking at the wrong page.
 21 MR. SHANK: The back of that.
 22 MR. CAZAKOFF: The page before
 23 it, page six.
 24 MR. SHANK: Does this graph
 25 reflect your daily investment process

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1 Walczak
 2 for managing the fund?
 3 THE WITNESS: Yes.
 4 MR. SHANK: So step one is to
 5 stress the fund for risk before making
 6 any investments?
 7 THE WITNESS: Yes.
 8 MR. SHANK: What does that mean?
 9 THE WITNESS: For me, what I
 10 would typically do is examine the
 11 parameters on the risk statement to see
 12 were we approaching or even at a high
 13 middle range, where were we on all of
 14 these different parameters, especially
 15 open option premium, margin and number
 16 of positions.
 17 MR. SHANK: So you used the
 18 parameters in Exhibit 5 to see if you
 19 were approaching the limits there?
 20 THE WITNESS: Correct, it gave
 21 me a sense for whether -- obviously
 22 nothing would have been triggered,
 23 otherwise that's a full stop and we are
 24 moving on to taking action, but it also
 25 gives me a sense for where on the

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1 Walczak
 2 continuum of risk are each of these
 3 metrics.
 4 MR. SHANK: Did stress the fund
 5 for risk mean anything other than
 6 looking at the metrics in Exhibit 5?
 7 THE WITNESS: I mean, again,
 8 back to my response earlier about using
 9 Option View to look out into the
 10 future, we would take a look at
 11 portfolio positioning across different
 12 option expiration months and across
 13 really the whole portfolio and
 14 identify, again, you know, what does it
 15 look like.
 16 MS. ALOISI: You were pretty
 17 clear you didn't do that daily, though,
 18 if I recall your earlier testimony; is
 19 that right?
 20 THE WITNESS: We didn't use
 21 Option View daily.
 22 MS. ALOISI: So that's not
 23 another one of the things you did to
 24 stress the fund for risk on a daily
 25 basis?

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1 Walczak
 2 THE WITNESS: Not on a daily
 3 basis, no. On a daily basis, we relied
 4 on the risk parameters.
 5 MR. WASSERMAN: We can go off
 6 the record.
 7 (Whereupon, a recess was taken.)
 8 Q Mr. Walczak, to the best of your
 9 recollection, can you describe to the best
 10 of your recollection what the fund's
 11 portfolio looked like at the end of November
 12 of 2016?
 13 A I can generally characterize it
 14 with a couple of caveats, one, I don't
 15 remember if there were puts in the portfolio
 16 or not. At the end of November of 2016, it's
 17 likely it had a reasonable number of call
 18 ratio spreads.
 19 Q Call ratio spreads for which
 20 expiries?
 21 A At the end of November, probably
 22 December, end of December, January, end of
 23 January and February, maybe even end of
 24 February, that's where I get a little
 25 unclear, but most expirations going forward.

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1 Walczak
 2 Q To be clear, when you are
 3 referring to the month generally, you mean
 4 the third week expiry?
 5 A The third Friday, yes.
 6 Q So you had call ratios for third
 7 week December, end of December, third week
 8 January, end of January, third week
 9 February, end of February, correct?
 10 A Again, without looking that's
 11 what's likely there.
 12 Q That was your practice, to have
 13 call ratio spreads at those expiries going
 14 out about 90 days, correct?
 15 A That would be normal, right.
 16 Q So at the end of November, that
 17 would likely be your position?
 18 A Correct. And again, there are
 19 periods of time where that didn't happen.
 20 For example, we might look at the end of
 21 December and discover that nothing fit our
 22 criteria to not have one there, but, again.
 23 Q Do you recall whether at the end
 24 of November of 2016 your call ratio
 25 positions over the ensuing three months were

<p style="text-align: right;">Page 225</p> <p>1 Walczak</p> <p>2 larger than your typical position size?</p> <p>3 A I don't recall precisely. I</p> <p>4 suspect that I would recall if they were.</p> <p>5 MR. SHANK: You said you would</p> <p>6 recall if they were larger?</p> <p>7 THE WITNESS: In other words, if</p> <p>8 they were pushing against the limits, I</p> <p>9 would likely remember that. So my best</p> <p>10 guess, again, a guess without looking,</p> <p>11 my best guess is they were not.</p> <p>12 Q Do you recall whether your</p> <p>13 positions in the February expiry were larger</p> <p>14 than your typical positions for a particular</p> <p>15 month?</p> <p>16 A I don't recall.</p> <p>17 Q Do you recall whether at the end</p> <p>18 of November of 2016 you had at all started</p> <p>19 to butterfly out any of the ratio spreads?</p> <p>20 A At the end of November, I don't.</p> <p>21 I believe there was a period of time where</p> <p>22 we did, but I don't know when we started.</p> <p>23 Q Do you recall at the end of</p> <p>24 November 2016 being aware of what the delta</p> <p>25 of the portfolio was?</p>	<p style="text-align: right;">Page 227</p> <p>1 Walczak</p> <p>2 certain level, correct?</p> <p>3 A It's really a combination of</p> <p>4 level and time. So in this case, I don't</p> <p>5 recall the basis for the loss. In other</p> <p>6 words, I can't tell you for sure whether the</p> <p>7 market went too high or went high too fast.</p> <p>8 Q Do you recall whether in the</p> <p>9 first week of December the portfolio had any</p> <p>10 short calls options for which the strike</p> <p>11 price was in the money?</p> <p>12 A That I don't recall, no.</p> <p>13 Q As the options get closer to the</p> <p>14 expiry, they become much more sensitive to</p> <p>15 market movement, correct?</p> <p>16 A Yes.</p> <p>17 Q Do you recall paying attention,</p> <p>18 in early December of 2016, do you recall</p> <p>19 paying attention to whether the third week</p> <p>20 December contracts were in the money or out</p> <p>21 of the money?</p> <p>22 A Again, I don't recall the</p> <p>23 specifics of what was going on. That would</p> <p>24 have been something that I would have</p> <p>25 observed.</p>
<p style="text-align: right;">Page 226</p> <p>1 Walczak</p> <p>2 A No.</p> <p>3 Q Do you recall the first week in</p> <p>4 December of 2016 being aware of what the</p> <p>5 delta of the portfolio was?</p> <p>6 A No.</p> <p>7 MR. SHANK: To be clear, you</p> <p>8 don't think you were aware?</p> <p>9 THE WITNESS: I don't recall.</p> <p>10 Q Do you recall there being a</p> <p>11 significant loss to the fund in early</p> <p>12 December of 2016?</p> <p>13 A Yes.</p> <p>14 Q Do you know what caused that</p> <p>15 loss?</p> <p>16 A I don't remember the specific</p> <p>17 market action, so just generally speaking --</p> <p>18 well, actually, thinking about it, the</p> <p>19 market went dramatically higher post</p> <p>20 election in November and I think that</p> <p>21 continued into the first part of December,</p> <p>22 so that's likely the reason.</p> <p>23 Q Specifically because the call</p> <p>24 ratio spreads, as you enter them, start to</p> <p>25 lose money when the market moves beyond a</p>	<p style="text-align: right;">Page 228</p> <p>1 Walczak</p> <p>2 Q Would you have a general sense</p> <p>3 of, in the beginning of December 2016, would</p> <p>4 it be your practice to have a general sense</p> <p>5 of how the portfolio would perform given a</p> <p>6 certain movement in the S&P?</p> <p>7 A What I would have been looking</p> <p>8 at, what I would typically look at as we</p> <p>9 approach that period of time is what's</p> <p>10 happening with the December options, where</p> <p>11 is my -- where is the market relative to</p> <p>12 my -- the maximum profit area of that</p> <p>13 particular position.</p> <p>14 Q Do you recall thinking to</p> <p>15 yourself or do you recall there being any</p> <p>16 red flags that came to your attention in the</p> <p>17 first half of December of 2016?</p> <p>18 A I recall that something</p> <p>19 occurred, I don't recall the specifics. I</p> <p>20 don't remember whether it was a particular</p> <p>21 risk parameter that triggered or certainly</p> <p>22 volatility in the fund's NAV, but there</p> <p>23 was -- our risk committee did discuss the</p> <p>24 fund's performance during that time and</p> <p>25 evaluate options or alternatives.</p>

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1 Walczak
2 Q Did the risk committee have
3 those discussions before or after the
4 drawdown in the first week of December?
5 A That I don't remember, whether
6 it was just before or just after, during. I
7 don't remember exactly, but I do know it was
8 the first part of December.
9 Q I believe the drawdown started
10 on December 7th. Does that sound
11 approximately right to you?
12 A It was certainly in the first
13 half of December, that's what I can say for
14 sure.
15 Q Do you recall in the days
16 leading up to December 7th noticing any red
17 flags in your portfolio?
18 A I don't recall specifically.
19 Q What tools were you using at
20 that time to evaluate risk in the portfolio?
21 A The same tools that I always
22 use, which is on our Exhibit 5 risk matrix.
23 Q Were any of those risk metrics
24 triggered in the days before December 7th?
25 A I don't recall that.

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1 Walczak
2 Q You don't recall whether they
3 were or not?
4 A That's right.
5 Q Mr. Walczak, I'm going to put in
6 front of you an exhibit that's Bates stamped
7 Catalyst 1.13, could we please mark this as
8 Exhibit 8.
9 (Photocopy of trade log, dated
10 December 2016, was marked Commission
11 Exhibit 8 for identification, as of
12 this date.)
13 Q Mr. Walczak, do you recognize
14 this document?
15 A I know what it is. I don't know
16 that I have specifically looked at this
17 before, but I know what it is.
18 Q What is it?
19 A It's a trade log for December of
20 2016.
21 Q Do you notice on this trade log
22 whether there are any trades that occur for
23 your portfolio on December 7th or 8th?
24 A I do not see any.
25 Q There is maybe a dozen trades

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1 Walczak
2 that appear to be made on December 9th,
3 could you walk us through what those appear
4 to be? For example, the first trade on
5 December 9th appears to be the purchase of a
6 December third week option with a strike of
7 2255. What role would that trade play in
8 your portfolio?
9 MR. MOYLE: What date are you on
10 again?
11 MR. WASSERMAN: December 9th.
12 A What I'm trying to do is
13 identify whether -- you see in the trade
14 log, if I did a spread trade, it would
15 appear as two lines, so I have to take a
16 look to see whether or not there is a
17 potential spread trade in there or whether
18 this was a unique purchase. The one thing I
19 can tell, it appears as though it may be
20 part of a -- one part of a rolled
21 transaction, that's one guess from looking
22 at the log and -- yes, that looks like, in
23 fact, I see three trades on here that look
24 similar.
25 Q What three trades are those?

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1 Walczak
2 A Well, three collections of
3 trades that appear to me to be a spread.
4 Q Can you identify those?
5 A The thousand lot that you
6 referred to followed by the next six lines
7 look like I purchased a thousand calls and
8 offset that with the sale of 500 at a higher
9 strike price at a further expiration month.
10 So this was an effort to derisk the
11 portfolio by doing two things, by basically
12 cutting in half the number of open calls and
13 moving --
14 Q How do you get cutting in half
15 the number of open calls?
16 A We bought a thousand and sold
17 500.
18 Q Okay. Well, for you, but that's
19 not half of the overall portfolio?
20 A No, no.
21 Q You just happen to buy, on this
22 particular day in this series of seven
23 transactions that you've identified, you
24 just happen to buy a thousand and sell 500?
25 A Well, I wouldn't characterize it

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1 Walczak
2 as just happen to, but that's a spread
3 technique that we use to take risk off.
4 Q You reduced the number of short
5 calls in the aggregate of your portfolio by
6 500 contracts?
7 A Correct. And it looks as though
8 we did that three times that day at the same
9 strike, so we did a total of -- we reduced a
10 total of 1,500 calls.
11 Q So you appeared to have rolled
12 some exposure from the third week December
13 to the third week January by buying back
14 3,000 worth of short calls and selling 1,500
15 worth of calls in the January expiry?
16 A That's correct, and that's also
17 a typical technique for us. If we have a one
18 by three and the three strike is either
19 causing us too much risk or too close to the
20 money or for some reason, our typical
21 methodology to deal with that is essentially
22 buying back one of the three's outright and
23 then moving the second of the three to a
24 further out strike, further out month and
25 this is how it gets accomplished.

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1 Walczak
2 Q Do you recall what percentage of
3 your overall short portfolio risk exposure
4 3,000 contracts was?
5 A No.
6 Q Do you think it was a large
7 percentage or a small percentage?
8 A It was likely a material
9 percentage of the December option
10 expiration.
11 Q What about a percentage of the
12 overall portfolio?
13 A That I don't know.
14 Q Can you go back and can we do
15 the same exercise for December 5th and 6th?
16 Starting with the first December 5, 2016
17 trade, you appear to be selling a thousand
18 third week December contracts with a strike
19 price of 2210, do you see that?
20 A Yes.
21 Q Followed by the purchase of a
22 thousand end of month contracts at 2220, can
23 you explain those trades, specifically what
24 purpose they would have served in your
25 portfolio, if you can recall?

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1 Walczak
2 A I'm going to take a second to
3 look at the balance of the trades on that
4 day.
5 Q Sure.
6 A I can't offer an explanation on
7 that trade. Buying the December 2210 or
8 selling the 2210, buying the end of month
9 2220. Yes, without -- I would have to wonder
10 where the market is. I think that was,
11 again, it really is a guess, but my guess
12 would be that that was moving a long
13 position from December to the end of
14 December.
15 Q Those two trades represented
16 moving a long position from the third week
17 expiry to the end of month expiry?
18 A Yes. In other words, selling a
19 long and establishing a new long same
20 quantity further out.
21 Q And then the next two trades
22 appear to be the combined selling of a
23 thousand contracts at the end of month
24 expiry in December at the strike price of
25 2250, correct?

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1 Walczak
2 A Yes.
3 Q So that would be establishing a
4 shorter position for the end of month
5 December contract?
6 A Yes. So that means that we moved
7 a long from December to end of December and
8 the equivalent number of shorts as well.
9 Q Well, not that you moved shorts,
10 you just purchased an additional thousand
11 contracts of shorts for the end of December
12 expiry?
13 A Or sold.
14 Q I'm sorry, sold an additional
15 thousand contracts for the December expiry?
16 A Sure. And, again, I can't really
17 put that one in context. It's certainly
18 possible that I had established longs at
19 some point prior and this represented an
20 opportunity to establish shorts. It would be
21 unusual to establish shorts by themselves
22 without a corresponding set of longs. In
23 other words, as you can see, moving longs
24 and shorts, my best guess was that I was
25 doing something to rebalance the net long

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1 Walczak
 2 and short positions in the two December
 3 expiration months.
 4 Q Would it have been your practice
 5 in December of 2016 to go further short in
 6 one expiry so that you could buy higher call
 7 protection in another expiry?
 8 A Yes.
 9 Q In other words, to generate
 10 revenue to buy the additional call options
 11 in another expiry?
 12 A Yes, that's something we,
 13 again -- a typical tactic we use for risk
 14 management would be to sell one buy two and
 15 they might be in the same expiration, they
 16 might be across expirations.
 17 MR. SHANK: How common was it
 18 for you to take a step like this of
 19 selling one buying two?
 20 THE WITNESS: I would say it's
 21 not a common element of strategy except
 22 when risk mitigation is needed. It's a
 23 risk mitigation tool.
 24 MR. SHANK: How frequently would
 25 you say over the years you've used that

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1 Walczak
 2 risk mitigation tool?
 3 THE WITNESS: Across all the
 4 instances where risk mitigation tools
 5 were necessary, very common.
 6 MR. SHANK: How often is that?
 7 Is this something you've done three
 8 times in 13 years or 300 times?
 9 THE WITNESS: I mean, I'm not
 10 trying to avoid the answer, but the
 11 answer is it's a risk mitigation tool,
 12 so unless there is some kind of even
 13 moderate risk measure, this is not
 14 something we go out and do as part of
 15 the strategy. But when risk is present,
 16 depending on -- I mean, what that does
 17 is it caps the unlimited upside risk by
 18 putting on a position like that for at
 19 least some quantity of the calls. So in
 20 answer to your question, again, it's
 21 one of these questions where it's a
 22 common tool we use, but it's not a
 23 common situation, so I'm struggling a
 24 little bit to tell you that it's once a
 25 year or whatever.

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1 Walczak
 2 MR. WASSERMAN: Can we mark this
 3 as Exhibit 9, please.
 4 (Photocopy of email chain, dated
 5 December 9, 2016, was marked Commission
 6 Exhibit 9 for identification, as of
 7 this date.)
 8 Q Mr. Walczak, I have put a
 9 document in front of you Bates stamped
 10 Catalyst 003 00168. There is a text on the
 11 back as well. Could you take a moment to
 12 review it, please, in particular the texts
 13 from Kimberly to yourself that goes onto the
 14 back of the email.
 15 A Okay.
 16 Q Just for the record, the
 17 document reflects that the initial email in
 18 the chain is sent on Friday, December 9,
 19 2016 at 12:57 p.m., it's from Kimberly Rios
 20 to Ed Walczak, Jeremy O'Keefe and Paul
 21 Rieger. Mr. Walczak, who is Jeremy O'Keefe?
 22 A He is our floor broker. In other
 23 words, the guy who executes trades for us in
 24 my direction.
 25 Q In the pit?

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1 Walczak
 2 A In the pit.
 3 Q Who is Paul Rieger?
 4 A He is our introducing broker.
 5 You guys know what that means.
 6 Q Do you recall Kimberly sending
 7 you this email?
 8 A I mean, not this specific email,
 9 but I understand it.
 10 Q What does it mean?
 11 A So this is a small example of
 12 the types of things that we look at to
 13 identify, you know, potential for mean
 14 reversion and what we might need to do in a
 15 very short term. So she's alerting me to a
 16 couple of technical factors that she's noted
 17 and how that might influence short-term
 18 market behavior.
 19 Q What specific technical factors
 20 has she identified?
 21 A She talks about RSI, which
 22 stands for relative strength index.
 23 Q What are BB moves?
 24 A Bollinger Band.
 25 Q What is a Bollinger Band?

<p style="text-align: right;">Page 241</p> <p>1 Walczak</p> <p>2 A A Bollinger Band is a band</p> <p>3 that's drawn two standard deviations away</p> <p>4 from the 20-day average price.</p> <p>5 Q So there is a 20-day moving</p> <p>6 average price line, correct?</p> <p>7 A Right.</p> <p>8 Q And the Bollinger Band consists</p> <p>9 of two lines around that 20-day moving</p> <p>10 average, correct?</p> <p>11 A Actually -- yes, two lines, one</p> <p>12 above and one below, right.</p> <p>13 Q And specifically one two</p> <p>14 standard deviations above and one two</p> <p>15 standard deviations below?</p> <p>16 A Correct.</p> <p>17 Q How do you use Bollinger Bands?</p> <p>18 A Well, in this circumstance --</p> <p>19 well, really in most circumstances it's a</p> <p>20 measure on whatever time frame you are</p> <p>21 using. So if it's a daily, it's a measure</p> <p>22 that on a daily basis price is extended,</p> <p>23 it's gone to a place that is two standard</p> <p>24 deviations away from its recent average,</p> <p>25 last monthly average. That is suggestive</p>	<p style="text-align: right;">Page 243</p> <p>1 Walczak</p> <p>2 MR. SHANK: At this point you</p> <p>3 are trying to predict market movement?</p> <p>4 THE WITNESS: We are trying to</p> <p>5 identify probabilities and likelihoods</p> <p>6 of mean reversion.</p> <p>7 Q Based on prior market behavior?</p> <p>8 A Yes.</p> <p>9 Q She says, "It actually happened</p> <p>10 twice, though, in the tech bubble and both</p> <p>11 times the next week was down three plus</p> <p>12 percent." She continues on, "There was a</p> <p>13 time, though, in 2012 which you can see in</p> <p>14 the chart attached is an outlier. The move</p> <p>15 did pause, but continued to climb. This is</p> <p>16 the best example I could find for worse-case</p> <p>17 scenario actually seen in history since</p> <p>18 1999." Are you using the Bollinger Bands to</p> <p>19 try to evaluate what your worst-case</p> <p>20 scenario is?</p> <p>21 A The Bollinger bands and other</p> <p>22 things that we look at combine to form an</p> <p>23 overall perspective on probabilities going</p> <p>24 forward.</p> <p>25 Q Probabilities of what going</p>
<p style="text-align: right;">Page 242</p> <p>1 Walczak</p> <p>2 that price will flatten or at least slow</p> <p>3 down and not continue to advance rapidly.</p> <p>4 Q Why?</p> <p>5 A Because the meaning of a</p> <p>6 Bollinger Band means that price only hits it</p> <p>7 whenever the two sigma standard is, I think,</p> <p>8 five percent of the time.</p> <p>9 Q When Kimberly says, "It is</p> <p>10 extremely rare to have the SPX close outside</p> <p>11 the BB on a weekly basis," what does that</p> <p>12 mean?</p> <p>13 A That means that it's extremely</p> <p>14 rare if you plot that same 20-day moving</p> <p>15 average and standard deviation, but instead</p> <p>16 use weekly data instead of daily data.</p> <p>17 She's commenting on a weekly basis, it's</p> <p>18 extremely rare.</p> <p>19 Q Why is that important to you as</p> <p>20 the portfolio manager?</p> <p>21 A Well, again, it informs me on</p> <p>22 the likelihood of future market behavior, in</p> <p>23 this case a little bit longer term, over the</p> <p>24 next several weeks as opposed to the next</p> <p>25 several days.</p>	<p style="text-align: right;">Page 244</p> <p>1 Walczak</p> <p>2 forward?</p> <p>3 A Probability of different market</p> <p>4 scenarios.</p> <p>5 Q Specifically probability of the</p> <p>6 market going up versus down?</p> <p>7 A Yes.</p> <p>8 Q Why is that important to you as</p> <p>9 a portfolio manager?</p> <p>10 A Well, in most cases, it's not.</p> <p>11 In a case where we are preparing to make</p> <p>12 adjustments, it can inform me about how</p> <p>13 aggressive or not aggressive I should be</p> <p>14 with those adjustments.</p> <p>15 Q Specifically you are trying to</p> <p>16 figure -- well, your intention is to draw a</p> <p>17 conclusion as to what the probability is of</p> <p>18 the market moving up or down over the next</p> <p>19 few days, correct?</p> <p>20 A Right, in a very short term.</p> <p>21 Q Isn't that important to you</p> <p>22 because if the market moves up in the days</p> <p>23 after December 9th, the portfolio is going</p> <p>24 to suffer?</p> <p>25 A That's possible. I don't really</p>

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1 Walczak
 2 know, again, without looking at the chart or
 3 the portfolio where we were, but...
 4 Q Do you recall where December 9th
 5 was in relation to the drawdown you were
 6 having in December?
 7 A I don't unless you just
 8 mentioned it previously.
 9 Q Unfortunately I'm not testifying
 10 here. Do you recall when the drawdown was?
 11 A I don't recall a specific day.
 12 Certainly somewhere right around there.
 13 Q Does this email refresh your
 14 recollection as to what had been happening
 15 over the days prior to December 9th?
 16 A This email suggests to me that
 17 we were in a position that we would benefit
 18 from the market retreating, that's probably
 19 the reason why she surfaced the analysis.
 20 Q And lose from the market
 21 advancing?
 22 A Yes, probably.
 23 Q So in order to assess what steps
 24 you were going to take going forward, you
 25 wanted to know the probability of the market

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1 Walczak
 2 moving up or down over the following days?
 3 A Yes, that's a factor, yes.
 4 Q And to try to assess the
 5 probability of the market moving up and down
 6 over the following days, you looked at
 7 historical market data?
 8 A Yes.
 9 Q Did you look at anything else?
 10 A I don't recall specifically, but
 11 there are other things that I typically look
 12 at. I mean, she's got RSI, which we look at,
 13 and Bollinger Bands, which we look at. We
 14 look at price patterns, technical data.
 15 When I talk about price patterns, for
 16 example, we pay for research from a number
 17 of sources that identify certain
 18 statistically predictive patterns of price
 19 and breadth combinations, of market
 20 sentiment. And in point of fact, we use
 21 those far more often to help us optimize our
 22 entries then to really mitigate risk.
 23 Q Is there anything else you are
 24 considering in this period on or around
 25 December 9th?

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1 Walczak
 2 A I don't recall specifically
 3 other than to say I mentioned a whole suite
 4 of things that I look at very routinely. So
 5 it's likely that I was looking at other
 6 things as well.
 7 Q Does this or the previous
 8 exhibit we looked at refresh your
 9 recollection as to the magnitude of the
 10 fund's positions at that time?
 11 A No.
 12 Q Do they refresh your
 13 recollection as to more detail about the
 14 character of the fund's position at that
 15 time?
 16 A I think I testified that it's
 17 likely -- the drawdown was in there
 18 somewhere, it's very likely that it was
 19 here. It's very likely that we were in call
 20 ratio positions and in the middle of a
 21 reasonable severe drawdown.
 22 Q Do you recall taking any
 23 specific measures in the first days of
 24 December to limit your downside to eight
 25 percent?

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1 Walczak
 2 A No, I don't recall that.
 3 MR. SHANK: Whose idea was it to
 4 take these defensive trades?
 5 THE WITNESS: That would be me.
 6 MR. SHANK: Did anyone else have
 7 input into that decision?
 8 THE WITNESS: We did have, at
 9 some point, again, relative to the
 10 trades we just spoke about, I don't
 11 remember the exact timing, but we did
 12 our risk committee get together and
 13 review alternative actions. But, you
 14 know, ultimately if there is a trade on
 15 the log, I made the trade and whether
 16 or not it was with input from the risk
 17 committee is a question of timing and I
 18 don't remember exactly.
 19 MR. SHANK: Who's on the risk
 20 committee.
 21 THE WITNESS: In December it was
 22 David Miller, George Amrhein, Jerry
 23 Szilagyi, Mike Schoonover and then, of
 24 course, Kimberly and I participated.
 25 We are not formal members of the

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1 Walczak
 2 standing risk committee, but we
 3 participated.
 4 MR. SHANK: How common was it to
 5 have meetings with the risk committee
 6 on management of the fund?
 7 THE WITNESS: It was very
 8 uncommon.
 9 MR. SHANK: Can you describe for
 10 me what was discussed at this meeting?
 11 THE WITNESS: Again, I don't
 12 recall the specifics, but I certainly
 13 can characterize the nature of the
 14 discussion and that is, again, whether
 15 it was -- you know, the drawdown, I
 16 recall, was high single digits in the
 17 first part of December. So whether the
 18 committee came together after the first
 19 four percent, the first day of three,
 20 four, whatever it was, I don't really
 21 know those details, but whatever
 22 prompted the committee to come
 23 together. The nature of the discussion
 24 was around what does the portfolio look
 25 like, what actions can we take to

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1 Walczak
 2 mitigate risk and there was a general
 3 discussion, you know, largely with my
 4 input around, I could do this, I could
 5 do that, here's the pros and cons,
 6 suggestions from the group. So that's a
 7 typical, you know, type of dialogue.
 8 MR. SHANK: Did anyone express
 9 any opinions in this meeting as to the
 10 amount of exposure in the fund at that
 11 time?
 12 THE WITNESS: It's possible. I
 13 don't recall exactly. I don't know if
 14 minutes were taken or not.
 15 MR. SHANK: Do you remember
 16 anyone expressing concern or anger
 17 regarding the amount of exposure the
 18 fund had at that time?
 19 THE WITNESS: I don't recall.
 20 Again, unfortunately we have had
 21 very -- quite a few risk meetings
 22 subsequent to that, so the individual
 23 meetings are not really clear and
 24 separate in my mind, so...
 25 Q To be clear for the record, you

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1 Walczak
 2 are referring to a meeting that you recall
 3 during or immediately after the December
 4 drawdown, correct?
 5 A Yes.
 6 Q Do you think at that meeting
 7 that Mr. Szilagyi had an understanding of
 8 what your portfolio strategy was?
 9 A Yes.
 10 Q Do you think that Mr. Szilagyi
 11 at that meeting had an understanding of the
 12 market conditions under which the fund would
 13 lose money?
 14 A Yes.
 15 Q Do you think at that meeting
 16 that Mr. Szilagyi had an understanding of
 17 the magnitude of potential losses in the
 18 portfolio?
 19 A That I'm not sure of.
 20 Q At that meeting, did you have an
 21 understanding of the magnitude of the
 22 potential losses of the portfolio?
 23 A Well, I think I've sort of
 24 commented on this before. It's not -- we are
 25 not going to act differently on the basis of

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1 Walczak
 2 a specific number. It's more about being in
 3 a position where we have to take significant
 4 action.
 5 Q In the days leading up to the
 6 drawdown, and to be clear, the drawdown
 7 consisted of a series of four or five
 8 trading days in which the fund's NAV
 9 consistently decreased, correct?
 10 A I don't remember for sure, but
 11 that's a likely path.
 12 Q And that it significantly
 13 decreased approximately ten percent?
 14 A That sounds approximately
 15 correct.
 16 Q In the days before that drawdown
 17 occurred, do you recall whether you had an
 18 understanding of the potential losses that
 19 the portfolio could face?
 20 A Again, I think -- I responded to
 21 that question in a lot of different
 22 circumstances and I have to elaborate. It's
 23 not as though any of us, myself included,
 24 are ignoring risk. We are balancing risk, we
 25 are doing things we have done for ten years

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1 Walczak
2 and by taking premature action in those
3 situations, you expose the fund to risk as
4 well.
5 Q Let me ask it another way. At
6 the beginning of December, you have call
7 ratios on for the third week December
8 expiry?
9 A Right.
10 Q The end of month December
11 expiry, the third week of January expiry,
12 end of month January expiry, third week
13 February expiry an end of month February
14 expiry, correct?
15 A Correct.
16 Q For your positions in each of
17 those expiries, there is an S&P range within
18 which that specific part of the portfolio
19 makes money, correct?
20 A Yes.
21 Q And there is a maximum amount of
22 money that can be made in the call ratio
23 spreads for a particular expiry, right?
24 A Right.
25 Q Did you know at that point in

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1 Walczak
2 time, at the beginning of December, what
3 that maximum amount of money was?
4 A It's routine for me to look at
5 that. In other words, as I mentioned
6 particularly as we approach an expiration
7 month, then I focus on that expiration month
8 to manage those positions with more detail.
9 In other words, I'm looking at those pretty
10 much all day long watching how they are
11 moving. And it's also normal for me to look
12 at each expiration month occasionally to
13 understand what the reward potential is, but
14 in terms of saying, adding it all up,
15 there's certainly times I have done that. I
16 can't say that I did it on this time or not.
17 Q And on the call ratios, as we
18 discussed, there is potential unlimited
19 downside, correct?
20 A Yes, there is.
21 Q And in some circumstances, it
22 was your practice to place additional calls
23 above your short strikes to butterfly out
24 some of the ratio spreads, correct?
25 A Yes.

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1 Walczak
2 Q And butterfly options in those
3 circumstances have a maximum loss, correct?
4 A Yes. They limit the risk, yes.
5 Q If you have an equal number of
6 long calls and short calls, there is a
7 maximum loss, correct?
8 A If they are placed correctly,
9 that's right.
10 Q But it was your practice, at
11 least for a piece of the portfolio, to cap
12 some of the call ratio spreads, correct?
13 A Well, again, that depends on the
14 market conditions. There were a whole set of
15 defensive tools in the tool kit and the
16 butterfly impact was one of them. Again, my
17 judgment was based on the local market
18 conditions and the location, I mean, the
19 whole complexity of the portfolio, whether
20 that was the right tool to use. So it was a
21 tool available, it was something that I did,
22 not always. Sometimes we rolled them,
23 sometimes we took them off, you know, for
24 example, of other tools.
25 Q Was it your practice in early

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1 Walczak
2 December 2016 to understand the maximum loss
3 for the piece of the portfolio that was
4 butterflyed?
5 A That's not how -- that's just
6 not how I looked at it. I didn't look and
7 say well, I have got some butterflies here,
8 so now my loss is capped at X.
9 Q So it wasn't your practice to
10 know what the maximum losses were on a piece
11 of the portfolio that was butterflyed?
12 A I don't recall specifically
13 making that calculation, no.
14 Q And there is a piece of your
15 portfolio that's not butterflyed, correct?
16 A Yes.
17 Q Specifically there are call
18 ratios that are not capped and have
19 unlimited losses, correct?
20 A Yes.
21 Q And that was the case in early
22 December of 2016, correct?
23 A As far as I know, right, without
24 looking at the portfolio.
25 Q Were you paying any attention to

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1 Walczak
 2 how quickly those losses could accumulate if
 3 the market were to move, for example, one or
 4 two points to the upside?
 5 A One or two points to the upside?
 6 Q Yes.
 7 A I mean --
 8 MR. CAZAKOFF: Percent.
 9 Q I'm sorry, one or two percent to
 10 the upside.
 11 A Again, I mean, I certainly
 12 looked at the numbers at various points in
 13 times, I think I have testified to that
 14 effect. And, again, that certainly -- you
 15 know, it's a part of the valuation about is
 16 some other risk trigger in play, do I have
 17 to make an adjustment on that basis, what is
 18 the overall trade-off between making an
 19 adjustment too soon and, again --
 20 Q What specific types of
 21 adjustments are you referring to?
 22 A Risk adjustments.
 23 Q Specifically what?
 24 A Butterfly is one tool that I
 25 have talked about.

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1 Walczak
 2 Q And specifically for the
 3 purposes of your portfolio, that means
 4 buying calls with strikes above your short
 5 strikes?
 6 A Yes.
 7 Q Okay.
 8 A Another tool is to roll options
 9 further out in time further away from the
 10 market. That decreases the risk in the
 11 nearby market move. Sometimes just taking a
 12 position off, which we did as well. So,
 13 again, in the context of how the fund
 14 operates, I have to keep coming back to the
 15 fact that we operate against a set of risk
 16 parameters that have served us well and I'm
 17 just not certain that the reacting to a
 18 potential loss under unpredictable market
 19 conditions, that's just not something that I
 20 incorporated into my practice, it's not a
 21 part of that --
 22 Q Specifically it wasn't your
 23 practice to understand the dollar amount of
 24 potential losses to your portfolio under
 25 specific market conditions?

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1 Walczak
 2 A It wasn't a part of my practice
 3 to react to those losses other than reacting
 4 to the --
 5 Q The question is, I'm sorry, Mr.
 6 Walczak, the question is whether it was your
 7 practice to understand the potential dollar
 8 amount of gains or losses to your portfolio
 9 given certain movement in the market?
 10 A Yes, actually, it was a practice
 11 to do that.
 12 Q So in early December of 2016
 13 prior to the December drawdown, do you
 14 recall having an understanding of what the
 15 fund's potential losses were if the market
 16 were to move up two percent?
 17 A I remember on at least some
 18 occasions, as I have testified, looking at
 19 the Options graph.
 20 Q What Options graph?
 21 A In Option View, the portfolio
 22 value.
 23 Q You recall specifically looking
 24 at something that told you the aggregate
 25 potential losses to the portfolio?

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1 Walczak
 2 A Yes.
 3 Q At that time in early December?
 4 A I'm certain I did it at least
 5 once.
 6 Q Do you recall what it told you?
 7 A No.
 8 Q Do you recall reacting to it in
 9 any way?
 10 A Not to the value -- not to the
 11 specific value of the number, no.
 12 Q Do you recall reacting to it at
 13 all?
 14 A My typical practice would be to
 15 at least understand the magnitude so that I
 16 could understand how to react should one of
 17 our other risk metrics trigger.
 18 MS. ALOISI: Did you share that
 19 information with anyone?
 20 THE WITNESS: I don't recall
 21 whether I did or not. I can't say that
 22 that would be my practice.
 23 MR. SHANK: What was the amount
 24 of exposure that you observed?
 25 THE WITNESS: I don't recall.

<p style="text-align: right;">Page 261</p> <p>1 Walczak</p> <p>2 MR. SHANK: Do you have any</p> <p>3 sense?</p> <p>4 THE WITNESS: No.</p> <p>5 MR. SHANK: What were your</p> <p>6 parameters that you were using in</p> <p>7 evaluating the potential exposure?</p> <p>8 Like assumptions for market movements</p> <p>9 or the like.</p> <p>10 THE WITNESS: Well, what I would</p> <p>11 normally do is in Option View, again,</p> <p>12 it's aggregating all the impacts on the</p> <p>13 portfolio value, which include time, so</p> <p>14 I'm looking at five different time</p> <p>15 frames and I can vary those. I'm going</p> <p>16 to look out and say what if the market</p> <p>17 moves X -- and, again, it's more you</p> <p>18 are looking conceptually at the graph</p> <p>19 and identifying numbers up and down,</p> <p>20 varying volatility. It's really not as</p> <p>21 easy as saying what if the market moves</p> <p>22 one or two percent because if it moves</p> <p>23 one or two percent tomorrow and</p> <p>24 volatility moves, it's a different</p> <p>25 answer than if it moves one or two</p>	<p style="text-align: right;">Page 263</p> <p>1 Walczak</p> <p>2 one or two percent up move in the S&P, your</p> <p>3 portfolio would decline in value?</p> <p>4 A It's very likely that I saw</p> <p>5 something that showed that it would decline</p> <p>6 in value on an up move. That's the typical.</p> <p>7 Q Do you recall Option View</p> <p>8 telling you at that time how much it would</p> <p>9 decline in value given a two percent up move</p> <p>10 in the market?</p> <p>11 A As I said, I'm certain that I</p> <p>12 looked at it, I don't recall magnitudes or</p> <p>13 numbers.</p> <p>14 MR. SHANK: Do you actually have</p> <p>15 a specific recollection of looking and</p> <p>16 seeing potential exposure for your</p> <p>17 entire portfolio in Option View in the</p> <p>18 December 2016 time frame?</p> <p>19 THE WITNESS: I don't have a</p> <p>20 specific time I can point to.</p> <p>21 MR. SHANK: So you are surmising</p> <p>22 that you did?</p> <p>23 THE WITNESS: Yes. As I said, I</p> <p>24 use Option View for a wide variety of</p> <p>25 things every day, most often evaluating</p>
<p style="text-align: right;">Page 262</p> <p>1 Walczak</p> <p>2 percent next week and volatility moves.</p> <p>3 Q Maybe you misunderstood my</p> <p>4 question. You can input your portfolio</p> <p>5 positions into Option View, correct?</p> <p>6 A Yes.</p> <p>7 Q Given your portfolio, is Option</p> <p>8 View capable of telling you, for example,</p> <p>9 how much money the portfolio will lose if</p> <p>10 the S&P declines one percent the next day,</p> <p>11 if the S&P goes up one percent the next day?</p> <p>12 A Yes, it is, given the other</p> <p>13 inputs that I have to put in, what will</p> <p>14 happen to volatility, what will happen to</p> <p>15 the volatility across different points in</p> <p>16 the curve.</p> <p>17 Q So do you recall using Option</p> <p>18 View in that way in the days leading up to</p> <p>19 the December drawdown?</p> <p>20 A I use Option View, as I said,</p> <p>21 every day for lots of different purposes, so</p> <p>22 I don't have any way of recalling</p> <p>23 specifically what I did on those days.</p> <p>24 Q Do you recall Option View in</p> <p>25 early December 2016 telling you that given a</p>	<p style="text-align: right;">Page 264</p> <p>1 Walczak</p> <p>2 position entry and maybe as important</p> <p>3 evaluating position adjustment and how</p> <p>4 that impacts the portfolio.</p> <p>5 MR. WASSERMAN: Can we mark</p> <p>6 this --</p> <p>7 MR. SHANK: Sorry, one last</p> <p>8 follow-up. The risk committee meeting</p> <p>9 that you referred to before, was that</p> <p>10 an in-person meeting?</p> <p>11 THE WITNESS: No, that was on</p> <p>12 the phone.</p> <p>13 MR. SHANK: Were all the members</p> <p>14 of the risk committee on the call?</p> <p>15 THE WITNESS: Well, again, I</p> <p>16 don't even know that there was a formal</p> <p>17 risk committee prior to this. So this</p> <p>18 was perhaps the formation of the risk</p> <p>19 committee. The names I mentioned are</p> <p>20 people I recall being on the call and</p> <p>21 that's pretty much the risk committee.</p> <p>22 MR. SHANK: Did you take notes?</p> <p>23 THE WITNESS: I didn't, no.</p> <p>24 MR. SHANK: Do you know if</p> <p>25 anyone else took notes?</p>

<p style="text-align: right;">Page 265</p> <p>1 Walczak</p> <p>2 THE WITNESS: I don't know.</p> <p>3 MR. SHANK: Were any notes or</p> <p>4 summaries of the call distributed?</p> <p>5 THE WITNESS: I don't recall,</p> <p>6 but there may have been some emails,</p> <p>7 but I don't know for sure.</p> <p>8 MR. SHANK: Sorry, Sam.</p> <p>9 MR. WASSERMAN: Can we mark this</p> <p>10 as Exhibit 10, please.</p> <p>11 (Photocopy of email chain was</p> <p>12 marked Commission Exhibit 10 for</p> <p>13 identification, as of this date.)</p> <p>14 Q This is a document Bates stamped</p> <p>15 Catalyst 003 17309. Mr. Walczak, if you</p> <p>16 could take a moment to read the earliest in</p> <p>17 time email on this chain, which goes onto</p> <p>18 the second page. This is an email dated</p> <p>19 December 11, 2016, Sunday, from Larry Milder</p> <p>20 to a whole lot of people with Catalyst from</p> <p>21 their email address, but what I want to draw</p> <p>22 your attention to is that you are cc'd on</p> <p>23 the email at the bottom; is that correct?</p> <p>24 A Yes.</p> <p>25 Q And the subject of the email is</p>	<p style="text-align: right;">Page 267</p> <p>1 Walczak</p> <p>2 some alternatives that I felt were</p> <p>3 appropriate, which were the typical tools</p> <p>4 that I use, and I recall generally that we</p> <p>5 had a discussion around which of those</p> <p>6 alternatives or which combination made the</p> <p>7 most sense and in what speed and size to do</p> <p>8 them.</p> <p>9 Q What alternatives are you</p> <p>10 referring to?</p> <p>11 A Butterflying call spreads,</p> <p>12 closing positions, moving positions.</p> <p>13 Q Were you given any direction on</p> <p>14 any of those calls?</p> <p>15 A Well, typically Catalyst</p> <p>16 management convened the call and I would</p> <p>17 say, as in any business process, everyone's</p> <p>18 voice was heard and at the end of the day we</p> <p>19 agreed. And if there are -- so I don't want</p> <p>20 to characterize it as we got on the phone</p> <p>21 and Catalyst said Ed, you should immediately</p> <p>22 do this. This was a collaborative discussion</p> <p>23 and there was general agreement on what to</p> <p>24 do and we went off and executed it.</p> <p>25 Q What was their agreement?</p>
<p style="text-align: right;">Page 266</p> <p>1 Walczak</p> <p>2 "HFXAX communications." The second paragraph</p> <p>3 of Mr. Milder's email reads, "We have had</p> <p>4 calls with the portfolio, trading and</p> <p>5 management team over the weekend." Do you</p> <p>6 recall whether one of those calls he was</p> <p>7 referring to is the risk team call you were</p> <p>8 just discussing?</p> <p>9 A Certainly if there were multiple</p> <p>10 calls, it was probably all calls with the</p> <p>11 risk team.</p> <p>12 Q And he says, "And there is a</p> <p>13 plan in place to manage the risk of the</p> <p>14 fund." Do you recall this email?</p> <p>15 A I don't remember the email,</p> <p>16 but...</p> <p>17 Q Do you recall coming out of one</p> <p>18 of those calls that he's referring to and</p> <p>19 there being a plan in place to manage the</p> <p>20 risk of the fund?</p> <p>21 A Yes.</p> <p>22 Q What was that plan in place?</p> <p>23 A I don't remember, again, the</p> <p>24 exact details of the plan, but we formulated</p> <p>25 the plan as usual. I described to the group</p>	<p style="text-align: right;">Page 268</p> <p>1 Walczak</p> <p>2 A On the type of tactics to employ</p> <p>3 in mitigating risk.</p> <p>4 Q Specifically to enter into</p> <p>5 butterfly spreads?</p> <p>6 A I don't recall if we got into</p> <p>7 specific agreement, for example, on only do</p> <p>8 that or do some combination of all of the</p> <p>9 above. I just don't recall how specific it</p> <p>10 got, but discussion of alternatives and</p> <p>11 there was some agreement on generally what</p> <p>12 to do.</p> <p>13 Q What do you recall specifically</p> <p>14 there was agreement on?</p> <p>15 A The general strategy about what</p> <p>16 to do. In other words, it may have been a</p> <p>17 situation where I said I can do all three of</p> <p>18 these things, let me use my judgment on how</p> <p>19 to apply them or it may have been a</p> <p>20 situation where we agreed that I would do</p> <p>21 one of the things and that only.</p> <p>22 Q What specifically do you recall</p> <p>23 that there was agreement to do?</p> <p>24 A I don't recall the specifics</p> <p>25 other than we agreed on how to manage the</p>

<p style="text-align: right;">Page 269</p> <p>1 Walczak</p> <p>2 situation.</p> <p>3 Q Specifically what?</p> <p>4 A What -- at least what types of</p> <p>5 trade adjustments to the portfolio were</p> <p>6 necessary.</p> <p>7 Q You agreed to enter into certain</p> <p>8 types of trades?</p> <p>9 A Again, I don't remember the</p> <p>10 specifics, but I do remember that we came up</p> <p>11 with a plan, a strategy.</p> <p>12 Q What was the plan?</p> <p>13 A I don't remember the plan. The</p> <p>14 plan would involve executing the</p> <p>15 alternatives we discussed, among them would</p> <p>16 have been some of the techniques I could</p> <p>17 use.</p> <p>18 Q Do you recall what was agreed to</p> <p>19 on that phone call?</p> <p>20 A I'm certain we agreed on a path</p> <p>21 forward, certain types of activity and</p> <p>22 trades that I would take on Monday morning.</p> <p>23 Q Do you recall what specific</p> <p>24 patterns and trades you agreed to enter</p> <p>25 into?</p>	<p style="text-align: right;">Page 271</p> <p>1 Walczak</p> <p>2 friends in the market had become aware of a</p> <p>3 fund that had very large positions in the</p> <p>4 S&P index options?</p> <p>5 A No. Again, look, I don't recall</p> <p>6 specific emails or conversations on this</p> <p>7 item, but here it is, so clearly I did see</p> <p>8 it.</p> <p>9 Q Well, do you recall being</p> <p>10 notified by Jerry in or around December 9th</p> <p>11 that somebody in the market was aware of the</p> <p>12 large positions that you had in your</p> <p>13 portfolio?</p> <p>14 A It was very possibly a</p> <p>15 discussion at the risk committee.</p> <p>16 Q Were you generally aware that</p> <p>17 market participants were aware of the size</p> <p>18 of your positions?</p> <p>19 A What I'm aware of is that you</p> <p>20 can see this sort of speculation almost</p> <p>21 every day in the marketplace.</p> <p>22 Q What type of speculation?</p> <p>23 A The speculation about a big</p> <p>24 player that needs to liquidate or has this</p> <p>25 position or that position. That's floor</p>
<p style="text-align: right;">Page 270</p> <p>1 Walczak</p> <p>2 A No.</p> <p>3 MR. MOYLE: Sam, if you are</p> <p>4 going to move on to something new, can</p> <p>5 we take a break?</p> <p>6 MR. WASSERMAN: Can we go over</p> <p>7 one more document?</p> <p>8 MR. MOYLE: Sure.</p> <p>9 MR. WASSERMAN: Can we mark this</p> <p>10 as Exhibit 11. This is that a document</p> <p>11 Bates stamped Catalyst 003 16118, two</p> <p>12 pages.</p> <p>13 (Photocopy of email chain, dated</p> <p>14 December 9, 2016, was marked Commission</p> <p>15 Exhibit 11 for identification, as of</p> <p>16 this date.)</p> <p>17 Q Mr. Walczak, can you take a</p> <p>18 moment to read this document?</p> <p>19 A Okay.</p> <p>20 Q Do you recall receiving this</p> <p>21 email from Jerry on December 9, 2016?</p> <p>22 A Again, I don't remember the</p> <p>23 specific email, but I'm on it.</p> <p>24 Q Do you recall Jerry telling you</p> <p>25 on or about December 9th that one of his</p>	<p style="text-align: right;">Page 272</p> <p>1 Walczak</p> <p>2 trader gossip.</p> <p>3 Q Were you aware that on or about</p> <p>4 December 9th such speculation was being made</p> <p>5 about your portfolio?</p> <p>6 A When I got this email, it looked</p> <p>7 like it was me.</p> <p>8 MR. SHANK: Did you have a sense</p> <p>9 at the time how big of a player you</p> <p>10 were in the S&P futures options market?</p> <p>11 THE WITNESS: Yes.</p> <p>12 MR. SHANK: How big?</p> <p>13 THE WITNESS: We did monitor our</p> <p>14 volumes on the floor and we ranged -- I</p> <p>15 think we averaged maybe 15 percent of</p> <p>16 the volume, 15, 18 percent of the</p> <p>17 volume.</p> <p>18 Q Were you the largest individual</p> <p>19 player on the floor in this particular</p> <p>20 product?</p> <p>21 A I don't know for sure. I am told</p> <p>22 subjectively that there are maybe two others</p> <p>23 that are similar sized.</p> <p>24 Q Who are the two others?</p> <p>25 A I didn't ask for names.</p>

<p style="text-align: right;">Page 273</p> <p>1 Walczak</p> <p>2 Q Do you recall in the first half</p> <p>3 of December of 2016 whether there were any</p> <p>4 issues with your execution quality in the</p> <p>5 pit?</p> <p>6 A I don't recall any issues. No,</p> <p>7 not during this period of time.</p> <p>8 Q Do you recall at any period of</p> <p>9 time there being issues with your execution</p> <p>10 quality in the pit?</p> <p>11 A We did have some concerns in the</p> <p>12 February period.</p> <p>13 Q Specifically what were those</p> <p>14 concerns?</p> <p>15 A Concerns that we were getting a</p> <p>16 less than ideal execution price on our</p> <p>17 transactions because we were doing higher</p> <p>18 volume than we had done in the past.</p> <p>19 MR. WASSERMAN: We can take a</p> <p>20 quick break.</p> <p>21 (Whereupon, a recess was taken.)</p> <p>22 Q Mr. Walczak, after the December</p> <p>23 drawdown, or more specifically between the</p> <p>24 December drawdown and the beginning of</p> <p>25 February, did you at any point begin to use</p>	<p style="text-align: right;">Page 275</p> <p>1 Walczak</p> <p>2 dated January 26th and January 27th of 2017.</p> <p>3 Could you please take a moment to review the</p> <p>4 document? Do you recall around these dates</p> <p>5 Mr. Szilagyi sending you text messages?</p> <p>6 A I don't. It looks like he did,</p> <p>7 but I don't recall specifically.</p> <p>8 Q Does this document refresh your</p> <p>9 recollection as to when exactly you started</p> <p>10 to use delta as a metric to evaluate risk in</p> <p>11 the portfolio?</p> <p>12 A I mean, it's, I guess -- what I</p> <p>13 remember, this is January 27th, so somewhere</p> <p>14 in there is likely when we started to look</p> <p>15 at delta.</p> <p>16 Q In Jerry's email to you on</p> <p>17 January 26th at 3:35 p.m., this document</p> <p>18 reflects, "We need to discuss risk</p> <p>19 management for the fund. Only looking at</p> <p>20 number of positions per million does not</p> <p>21 appear to be an adequate way of measuring</p> <p>22 risk based on our experience, particularly</p> <p>23 the last two months." Do you agree with his</p> <p>24 statement?</p> <p>25 A At that time, I did agree as you</p>
<p style="text-align: right;">Page 274</p> <p>1 Walczak</p> <p>2 delta as a metric for evaluating risk in</p> <p>3 your portfolio?</p> <p>4 A We began to monitor delta and</p> <p>5 I'll characterize that as informal. I don't</p> <p>6 remember exactly when. I do remember</p> <p>7 certainly by the 1st of February and perhaps</p> <p>8 prior.</p> <p>9 MR. SHANK: To be clear, you</p> <p>10 were not monitoring delta before that</p> <p>11 late January/early February time</p> <p>12 period, correct?</p> <p>13 THE WITNESS: We certainly</p> <p>14 weren't monitoring it before the</p> <p>15 December drawdown, that's what I can</p> <p>16 say for certain. Somewhere between the</p> <p>17 December drawdown and the 1st of</p> <p>18 February, we began to look at it.</p> <p>19 MR. WASSERMAN: Can we mark this</p> <p>20 as Exhibit 12, please.</p> <p>21 (Photocopy of email chain was</p> <p>22 marked Commission Exhibit 12 for</p> <p>23 identification, as of this date.)</p> <p>24 Q This is a document Bates stamped</p> <p>25 Catalyst 003 00237. It's a chain of emails</p>	<p style="text-align: right;">Page 276</p> <p>1 Walczak</p> <p>2 see from my reply that it was reasonable to</p> <p>3 consider some addition to our risk matrix.</p> <p>4 Q To be clear, in your reply you</p> <p>5 don't say that you agree with his statement.</p> <p>6 I'm asking, do you agree with his statement?</p> <p>7 A On its face, I don't</p> <p>8 automatically agree. My sense was, look, I</p> <p>9 haven't used a delta-based metric in the</p> <p>10 life of the fund, it's a neutral strategy,</p> <p>11 it's not a delta-dependent strategy, all</p> <p>12 those reasons that we have talked about, but</p> <p>13 I agreed with his -- the sense of his</p> <p>14 paragraph that said the fund has exhibited</p> <p>15 too much volatility relative to the market,</p> <p>16 we should look at something new, that I</p> <p>17 agreed with.</p> <p>18 Q Where does it say the fund has</p> <p>19 exhibited too much volatility relative to</p> <p>20 the market?</p> <p>21 A Well, in Jerry's paragraph.</p> <p>22 Q You are paraphrasing?</p> <p>23 A Yes.</p> <p>24 Q I'm talking specifically about</p> <p>25 the statement, "Only looking at the number</p>

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1 Walczak
 2 of positions per million does not appear to
 3 be an adequate way of measuring risk based
 4 on our experience, particularly the last two
 5 months," do you agree with that statement?
 6 A At this time I had no data to
 7 agree or disagree. That's why I agreed to
 8 consider it. I wasn't going to say, wow,
 9 that's correct, I'm going to say let's take
 10 a look and see if there is something we can
 11 do.
 12 Q Sitting here today, do you agree
 13 with that?
 14 A Sitting here today, we have
 15 implemented and I do agree with a delta
 16 gamma metric.
 17 Q There is no reference to gamma
 18 in here. Sitting here today, do you agree
 19 with this statement as it's written in Mr.
 20 Szilagyi's email?
 21 MR. MOYLE: Just the one
 22 sentence he's talking about, only
 23 looking at that.
 24 A Yes, I agree with that.
 25 Q Next he says, "The net delta

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1 Walczak
 2 adjusted exposure based on our calculations
 3 seems to be around negative 500, which
 4 explains better why the fund was down
 5 negative five X the market movement on a
 6 pretty minor market move. I know you say you
 7 do not use this type of risk measure, but
 8 recent history seems to show it may be a
 9 better measure of risk or at least worth
 10 looking at." Do you recall whether at the
 11 time of this email you were using delta as a
 12 measure of risk for the fund?
 13 A I don't.
 14 Q Do you recall whether, after
 15 this email, you started to use delta as a
 16 measure of risk for the fund?
 17 MR. MOYLE: Can I just jump in
 18 here for a second? Do you mean him
 19 personally or are you using you for
 20 Catalyst?
 21 Q I mean you, Mr. Walczak.
 22 A I remember looking at delta
 23 certainly by the 1st of February.
 24 Q And what specifically, in
 25 looking at delta, what specifically were you

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1 Walczak
 2 looking for?
 3 A I was trying to evaluate, as I
 4 think we might have had a conversation, we
 5 being the risk committee, about was delta
 6 appropriate and, if so, what level. And my
 7 recollection says our agreement was let's
 8 monitor the delta and use our experience to
 9 determine what might be a reasonable measure
 10 to use as a risk control parameter.
 11 Q Did you draw any conclusions by
 12 the 1st of February as to what an acceptable
 13 level of delta would be for the fund?
 14 A I did not personally draw any
 15 conclusions. I think I do recall that others
 16 on the risk committee had an idea.
 17 Q Do you recall what their idea
 18 was of what an acceptable level of delta was
 19 for them?
 20 A It was less than three, two and
 21 a half. I don't recall specifically, but it
 22 was in that neighborhood.
 23 Q To clarify, do you mean, when
 24 you say "less than three," do you mean that
 25 the portfolio would move in no greater than

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1 Walczak
 2 three times the move of the S&P?
 3 A Yes, by the delta metric alone,
 4 yes.
 5 MR. SHANK: You said you didn't
 6 use delta because the fund was a
 7 market-neutral strategy, but how is a
 8 market-neutral strategy consistent with
 9 a delta of negative 500 percent?
 10 THE WITNESS: Well, again,
 11 because the way our neutral strategy
 12 operates is back and forth in the
 13 market and at certain extremes can
 14 exhibit that kind of delta. But, again,
 15 over years and years and years without
 16 even looking at it, I'm fairly
 17 confident we had that delta and higher.
 18 MR. SHANK: But delta also
 19 measures the marginal change, right, at
 20 the point where you are, not at the
 21 extremes, right?
 22 THE WITNESS: Right.
 23 MR. SHANK: So a one point move
 24 in the market moves you five percent
 25 the other way, right?

<p style="text-align: right;">Page 281</p> <p>1 Walczak</p> <p>2 THE WITNESS: Potentially, yes.</p> <p>3 MR. SHANK: So isn't your</p> <p>4 strategy significantly dependent on the</p> <p>5 movement of the market?</p> <p>6 THE WITNESS: Only at the</p> <p>7 extremes. And remember when I talk</p> <p>8 about a market-neutral strategy, I made</p> <p>9 that point earlier, it's not a</p> <p>10 delta-neutral strategy, no effort is</p> <p>11 made to neutralize delta exposure. The</p> <p>12 point of being a neutral strategy is to</p> <p>13 say we don't take any perspective on</p> <p>14 where the market is going to move. We</p> <p>15 don't go long or short the market.</p> <p>16 MR. SHANK: But you are going</p> <p>17 short in the market if you have a delta</p> <p>18 negative 500 percent, aren't you?</p> <p>19 THE WITNESS: We are as a result</p> <p>20 of market activity, not as a result of</p> <p>21 our bias one way or the other.</p> <p>22 MR. SHANK: As far as you said</p> <p>23 only at the extremes, but, again, we</p> <p>24 are only talking about a one percent</p> <p>25 move in the market moves you five</p>	<p style="text-align: right;">Page 283</p> <p>1 Walczak</p> <p>2 Q The first day of February, do</p> <p>3 you recall having call ratio spreads on for</p> <p>4 the third week February expiry?</p> <p>5 A Yes.</p> <p>6 Q On the first day of February,</p> <p>7 did you have call ratio spreads on for the</p> <p>8 end of February expiry?</p> <p>9 A Yes.</p> <p>10 Q Do you recall on February 1,</p> <p>11 2017 what the approximate size of those call</p> <p>12 ratio spreads were?</p> <p>13 A No.</p> <p>14 Q Does having a total number of</p> <p>15 short contracts in the ballpark of 50,000</p> <p>16 sound about right to you?</p> <p>17 A I don't know.</p> <p>18 Q This is your portfolio?</p> <p>19 A Right.</p> <p>20 Q That you've run for many, many</p> <p>21 years?</p> <p>22 A True.</p> <p>23 Q This is a major -- this February</p> <p>24 expiry was a major event for your fund,</p> <p>25 right?</p>
<p style="text-align: right;">Page 282</p> <p>1 Walczak</p> <p>2 percent, that's -- a one percent move</p> <p>3 in the market is not extreme, is it?</p> <p>4 THE WITNESS: It's only occurred</p> <p>5 two or three times all year this year.</p> <p>6 MR. SHANK: A one percent daily</p> <p>7 move?</p> <p>8 THE WITNESS: Yes.</p> <p>9 MR. SHANK: But over a couple of</p> <p>10 days, that wouldn't be extreme at all,</p> <p>11 would it?</p> <p>12 THE WITNESS: That's a good</p> <p>13 point because I would expect over a</p> <p>14 couple of days that some other portion</p> <p>15 of our risk profile would trigger and</p> <p>16 we would adjust.</p> <p>17 Q By the first day of February,</p> <p>18 you wouldn't have any January positions</p> <p>19 left, correct?</p> <p>20 A That's right. That's correct,</p> <p>21 yes.</p> <p>22 Q And at the risk of asking an</p> <p>23 obvious question, you wouldn't have any</p> <p>24 December positions left, right?</p> <p>25 A Correct.</p>	<p style="text-align: right;">Page 284</p> <p>1 Walczak</p> <p>2 A Right.</p> <p>3 Q This is six, seven, eight months</p> <p>4 ago now, right?</p> <p>5 A Yes.</p> <p>6 Q Do you recall the size of the</p> <p>7 position that you were holding in the</p> <p>8 February expiries on February 1st?</p> <p>9 A I don't and the reason is as</p> <p>10 a -- positions relative to portfolio against</p> <p>11 the metrics we monitor were not anywhere</p> <p>12 near our risk limits. So this was not</p> <p>13 something that was, you know, first and</p> <p>14 foremost blinking red lights saying oh, my</p> <p>15 gosh, you've got too many positions, so as a</p> <p>16 result, there isn't a number that sticks in</p> <p>17 my mind.</p> <p>18 Q Sitting here in retrospect, in</p> <p>19 hindsight, was there a lot of risk in your</p> <p>20 portfolio on February 1st?</p> <p>21 A In hindsight, yes.</p> <p>22 Q But the risk metrics that you</p> <p>23 had in place did not capture that risk?</p> <p>24 A For the first time in 12 years,</p> <p>25 that's correct.</p>

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1 Walczak
2 Q Well, they didn't capture it in
3 early December, correct?
4 A In December, the fund performed
5 as it has throughout its history.
6 Q Well, were any of the those risk
7 metrics flagged in early December?
8 A I don't recall whether they were
9 or not.
10 Q Do you recall any of the risk
11 metrics ever being flagged?
12 A I know they have been, but,
13 again, I don't recall specifics. You get a
14 signal, you deal with it and move on.
15 Q So how do you know it works if
16 they've never been flagged?
17 A They were flagged -- I know they
18 have been flagged.
19 Q When have they been flagged?
20 A I think it was July. The summer
21 of 2016 they were flagged.
22 Q What specifically was flagged?
23 A I think it was number of
24 positions and it may also have been margin.
25 Q Do you recall any other instance

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1 Walczak
2 prior to March of 2017 when the risk metrics
3 in Exhibit 5 were flagged?
4 A I don't recall specifically. It
5 wouldn't surprise me if you look at
6 drawdowns on the portfolio, for example, in
7 Q4 of '14 maybe, but I can't specifically
8 say that I remember.
9 Q But they were definitely not
10 flagged in early February of 2017?
11 A They were.
12 Q What risk metric in Exhibit 5
13 was flagged in early February of 2017?
14 A Open call premium.
15 Q How specifically was that
16 flagged?
17 A We went over at the time, I
18 think we had reduced it to six percent and
19 we went, in one day, we went up to a little
20 over seven and that's exactly what triggered
21 us to begin to adjust.
22 Q Let's take a look at February.
23 MR. WASSERMAN: Can we mark this
24 as Exhibit 13, please.
25 (Photocopy of trade log, dated

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1 Walczak
2 February 2017, was marked Commission
3 Exhibit 13 for identification, as of
4 this date.)
5 Q Do you recall when exactly in
6 February the fund started to lose money?
7 A If I had a calendar, I could
8 probably recall it, but I can't off the top
9 of my head.
10 Q A calendar, like literally a
11 calendar in front of you?
12 A Right.
13 Q Do you want to take a moment to
14 pull out a phone or have one of your lawyers
15 pull out a phone and look at a calendar for
16 February 2017?
17 A So I would have expected it to
18 be Thursday would be my best recollection..
19 Q Thursday, what?
20 A The 9th.
21 Q To the best of your
22 recollection, Thursday, February 9th was the
23 beginning of a major February drawdown,
24 correct?
25 A Yes. Again, it could have been

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1 Walczak
2 Wednesday, most likely Thursday, so that's
3 my best guess.
4 Q To be clear, it could have been
5 Wednesday, February 8th, was likely
6 Thursday, February 9th?
7 A Right.
8 Q Do you recall how long that
9 drawdown lasted?
10 A Well, by definition we are still
11 in it.
12 Q So let me rephrase the question.
13 Do you recall how much the fund lost over
14 the course of the next five trading days?
15 A Probably about 15 percent I
16 think.
17 Q I'm sorry?
18 A About 15 percent is what I
19 remember.
20 Q I have put a document in front
21 of you Bates stamped Catalyst 1.15. Do you
22 recognize this document?
23 A It's the February trade log.
24 Q Specifically it documents all of
25 the trades that the fund entered into in

<p style="text-align: right;">Page 289</p> <p>1 Walczak</p> <p>2 February 2017?</p> <p>3 A Correct.</p> <p>4 Q Do you want to take a moment to</p> <p>5 look at it?</p> <p>6 A Sure.</p> <p>7 Q Mr. Walczak, did you enter into</p> <p>8 any trades for the fund between February 1st</p> <p>9 and February 8th?</p> <p>10 A No.</p> <p>11 Q Do you recall whether any of the</p> <p>12 risk metrics in Exhibit 5 were triggered</p> <p>13 between February 1st and February 8th?</p> <p>14 A I don't believe so.</p> <p>15 Q Do you recall on February 1st,</p> <p>16 on or about February 1st, being aware of the</p> <p>17 risks associated with the portfolio?</p> <p>18 A I recall at that time beginning</p> <p>19 to focus on the February expiration having</p> <p>20 just traded through the January end of month</p> <p>21 expiration.</p> <p>22 Q Do you recall being aware of the</p> <p>23 risks associated with the portfolio on</p> <p>24 February 1st?</p> <p>25 A I certainly recall looking at</p>	<p style="text-align: right;">Page 291</p> <p>1 Walczak</p> <p>2 large category, so this merited attention.</p> <p>3 Q So let's ballpark it. What's</p> <p>4 large?</p> <p>5 A Five percent of the fund.</p> <p>6 Q So on February 1st, you are</p> <p>7 aware that a one percent up move in the S&P</p> <p>8 is going to result in about five percent</p> <p>9 losses for the fund?</p> <p>10 MR. MOYLE: Objection.</p> <p>11 A I don't recall the exact -- you</p> <p>12 asked me to define large, so large is five</p> <p>13 percent. And, again, at that point, I'm</p> <p>14 likely looking out, again, not recalling the</p> <p>15 specifics unfortunately, but I'm likely</p> <p>16 looking out at different time frames between</p> <p>17 February 1st and expiration. So a one</p> <p>18 percent move the next day was probably more</p> <p>19 severe than a one percent move into</p> <p>20 expiration.</p> <p>21 Q But you didn't enter into any</p> <p>22 trades on February 1st?</p> <p>23 A No.</p> <p>24 Q You didn't enter into trades on</p> <p>25 February 2nd?</p>
<p style="text-align: right;">Page 290</p> <p>1 Walczak</p> <p>2 what the February expiration risk profile</p> <p>3 looked like in terms of price levels and</p> <p>4 potential declines.</p> <p>5 Q On February 1st, what did the</p> <p>6 risk profiles of the February expiries look</p> <p>7 like?</p> <p>8 A Again, what I recall is that it</p> <p>9 looked as though -- see, I struggle with</p> <p>10 specific levels. I can describe what I was</p> <p>11 looking at, meaning, my recollection is it</p> <p>12 looked like about a 20, 25 point S&P move</p> <p>13 would cause a reasonably large drawdown, so</p> <p>14 I had that in my mind.</p> <p>15 Q What's a 25 point S&P move in</p> <p>16 percentage terms at that point?</p> <p>17 A One percent.</p> <p>18 Q And specifically as you</p> <p>19 understood it on February 1st, how large a</p> <p>20 drawdown would a one percent move in the S&P</p> <p>21 cause the portfolio --</p> <p>22 A I don't remember the specific</p> <p>23 number and that's, again, how I think I have</p> <p>24 testified, the way I look at it is large</p> <p>25 versus not so large. So this was in the</p>	<p style="text-align: right;">Page 292</p> <p>1 Walczak</p> <p>2 A No.</p> <p>3 Q I'm going to miss what's the</p> <p>4 weekend here, but you said the 9th was a</p> <p>5 Thursday?</p> <p>6 A Yes.</p> <p>7 Q And you didn't enter into any</p> <p>8 trades on February 3rd?</p> <p>9 A No.</p> <p>10 Q And you didn't enter into any</p> <p>11 trades on February 6th?</p> <p>12 A No.</p> <p>13 Q On February 6th, do you recall</p> <p>14 having an idea of how much the portfolio</p> <p>15 would lose if the S&P went up one percent</p> <p>16 over the following week?</p> <p>17 A I don't recall specifics other</p> <p>18 than it was less than the loss that would</p> <p>19 have been experienced on February 1st</p> <p>20 because time had passed and I believe the</p> <p>21 market was fairly flat.</p> <p>22 Q Well, where was the market</p> <p>23 relative to your short strikes for the third</p> <p>24 week February expiry?</p> <p>25 A I don't remember that exactly.</p>

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1 Walczak
2 Q If the market were above your
3 short strikes for the third week February
4 expiry, would what you just said be true?
5 A Yes.
6 Q That the potential losses to the
7 portfolio would be less than they were on
8 February 1st?
9 A If I'm correct that the market
10 was flat during that time, yes.
11 Q As you get closer to expiry, the
12 options become more sensitive to price
13 movement; do they not?
14 A Yes.
15 Q Specifically your S&P options on
16 S&P futures become more sensitive to
17 movements in the underlying asset, correct?
18 A All options do.
19 Q But you did not enter into any
20 trades on February 6th?
21 A No.
22 Q You did not enter into any
23 trades on February 7th?
24 A No.
25 Q And you did not enter into any

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1 Walczak
2 trades on February 8th?
3 A No.
4 Q Why not?
5 A According to my process, there
6 was no reason to enter trades.
7 Q What was your process that
8 wasn't giving you any reason to enter
9 trades?
10 A We are coming into expiration,
11 the positions were slightly closer to the
12 market, but we were still well above our
13 expiration break-even with about a week and
14 a half to go.
15 Q What does that mean, you were
16 well above your expiration break-even?
17 A I should say well below. In
18 other words, again, I don't remember the
19 specific market level, but I do remember
20 that where the market was was below the
21 break-even point for the February positions.
22 Q For the third week February
23 positions?
24 A Yes.
25 Q What about for the end of

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1 Walczak
2 February positions?
3 A Again, my recollection is that
4 those were further away from the market.
5 Q Do you recall whether, at any
6 time on February 6th, 7th or 8th, you had an
7 understanding of how the portfolio would
8 perform given a certain degree of upward
9 movement in the S&P?
10 A I remember looking at the graph,
11 yes.
12 Q And what did it tell you?
13 A It told me what I think I just
14 described, is that we were in a good spot
15 going into expiration, that there was risk
16 to the upside, significant, so I was
17 prepared to take action.
18 Q Specifically what was that risk
19 to the upside?
20 A It's normal risk in the
21 portfolio. Again, I don't remember dollar
22 amounts.
23 Q Do you remember being aware of
24 the dollar amount at the time prior to
25 February 9th?

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1 Walczak
2 A Honestly I don't remember.
3 MR. WASSERMAN: Can we mark this
4 as Exhibit 14, please?
5 (Photocopy of spreadsheet was
6 marked Commission Exhibit 14 for
7 identification, as of this date.)
8 Q This is a document Bates stamped
9 Catalyst 003 23755. Mr. Walczak, do you
10 recognize this document?
11 A I don't know that I have seen it
12 before, but I understand what it's telling
13 us.
14 Q Were you ever given a document
15 like this prior to February 9th of 2017?
16 A I don't recall that I was given
17 a document that looked like this. I do
18 recall the delta information on here. I
19 don't remember for sure if it was this
20 document.
21 Q So you recall being given the
22 delta information for the portfolio in the
23 days leading up to February 9th?
24 A Yes, I remember, as I mentioned
25 before, that certainly beginning the 1st of

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1 Walczak
 2 February I recall looking at deltas.
 3 Q And do you recall what exactly
 4 the delta was on those first days in
 5 February?
 6 A Well, I can see them here, but I
 7 also do recall that the deltas were in the
 8 mid three's. And as I mentioned, my
 9 recollection says that our goal initially
 10 was to get it down under three somewhere and
 11 that was my goal going into February
 12 expiration.
 13 Q Did you succeed in that goal
 14 from February 1st to February 8th?
 15 A No. What I mean by the goal, the
 16 goal was to come out of February expiration
 17 with a delta under three.
 18 Q But isn't the important thing
 19 what delta is going into the February
 20 expiration?
 21 A I can only repeat that delta is
 22 not something used to manage the portfolio
 23 even to this day, we use it as a risk
 24 trigger.
 25 Q Say that again?

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1 Walczak
 2 A Delta is not something we use to
 3 manage the portfolio even today, after we
 4 formally adopted a metric, we use it as a
 5 risk trigger, not as a portfolio management
 6 tool.
 7 Q But you were aware on February
 8 3rd, for example, that the delta of the
 9 portfolio was approximately negative three
 10 and a third?
 11 A Yes, I recall roughly those
 12 numbers.
 13 Q And do you recall that on
 14 February 7th, it was approximately negative
 15 4.4?
 16 A Yes.
 17 Q And that on February 8th, it was
 18 approximately negative 4.7?
 19 A Again, I'm certain I was looking
 20 at these numbers, yes.
 21 Q You are certain that you were
 22 looking at these numbers on those particular
 23 dates in early February?
 24 A That's my general recollection,
 25 that I was looking at delta on a daily basis

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1 Walczak
 2 then.
 3 Q But you weren't entering into
 4 any trades on these days?
 5 A No.
 6 Q Were these delta numbers a cause
 7 of any concern for you?
 8 A As I mentioned, you don't manage
 9 the fund to delta. I had no history to
 10 determine whether or not these deltas should
 11 be a cause of concern.
 12 Q What about the vega numbers,
 13 were you aware of the vega numbers reflected
 14 on the spreadsheet in the first days of
 15 February 2017?
 16 A No.
 17 Q Were you at all paying attention
 18 to vega from February 1st to February 8th
 19 2017?
 20 A No.
 21 MR. SHANK: What do these vega
 22 numbers mean?
 23 THE WITNESS: I don't know. I
 24 don't really understand how to
 25 translate that into anything.

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1 Walczak
 2 MR. SHANK: Were you getting
 3 these reports daily?
 4 THE WITNESS: I remember getting
 5 a delta number. I don't remember
 6 specifically this particular report.
 7 Q Do you remember calculating the
 8 delta yourself or receiving it from
 9 somebody?
 10 A Receiving it.
 11 Q Who do you recall receiving it
 12 from?
 13 A I'm going to guess Mike
 14 Schoonover.
 15 Q Who is Mike Schoonover?
 16 A He's currently chief operating
 17 officer for Catalyst, but at the time he was
 18 a portfolio manager who also did analytical
 19 support for George Amrhein, I believe.
 20 Q At this point in early -- from
 21 February 1st to February 8th, what's the
 22 approximate size of the fund in assets under
 23 management?
 24 A Under four billion by a little
 25 bit maybe. That's a guess.

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1 Walczak
2 Q Under four billion by a little
3 bit you said?
4 A That's a guess, yes.
5 Q How much is "a little bit"?
6 A How much is my guess tolerance?
7 Q Is it greater than 3.7 billion?
8 A Probably.
9 Q Do you recall what you were
10 looking at from February 1st to February 8th
11 to evaluate risk in the portfolio?
12 A Yes, I looked at my position
13 size and saw that it was low in the range
14 and well under the limit. I looked at my
15 open call premium, saw the same thing. I
16 looked at my margin, saw the same thing.
17 Q Did you look at anything else?
18 A That's what I remember looking
19 at. I mean, as I have testified, I certainly
20 at some point in this period looked at the
21 risk profile for the February expiration.
22 Q Do you recall anything in that
23 period of February 1st to February 8th
24 giving you cause for concern?
25 A I was certainly concerned about

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1 Walczak
2 how to manage the February expiration period
3 positions, if the market became -- started
4 to rise.
5 Q Did the market start to rise?
6 A It did on the 9th.
7 Q What happened when it started to
8 rise on the 9th?
9 A My recollection is I took action
10 as well as the risk metric triggered -- the
11 open call premium I think is what triggered
12 on the 9th.
13 Q And did that prompt you to take
14 any action?
15 A Yes.
16 Q What action did you take?
17 A The trades that are on the trade
18 log, which, again, constitute some
19 repurchase of short options and reselling of
20 them and I don't remember whether it was the
21 9th or the 10th. And, again, I'm not sure
22 exactly which of those days the risk metric
23 triggered, but we took action on the 9th and
24 then continued on the 10th and on the
25 11th -- the 13th and so on.

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1 Walczak
2 Q Do you recall at that time
3 having any issues with your execution
4 quality in the pit?
5 A There was -- quality issues came
6 up, I would -- it's a guess because I'm
7 trying to remember what days of the week and
8 what we were doing, but my best recollection
9 would be on the Monday, the 13th.
10 Q That execution quality issues
11 came up?
12 A Yes.
13 Q Specifically what were those
14 execution quality issues?
15 A Well, our floor broker reported
16 that he felt like there was some visibility
17 or expectation on the floor that we were
18 going to offset a large number of positions,
19 so he was experiencing poorer than normal
20 fill prices.
21 Q Did that exacerbate your losses?
22 A To some degree. I would say it's
23 a fairly minor part of the equation, but
24 certainly if we are -- execution quality is
25 always difficult to measure, but

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1 Walczak
2 subjectively I would say, sure, that was a
3 very tiny contribution.
4 Q Specifically the amount of
5 position -- the size of the position you had
6 to cover was causing the execution issues?
7 A Yes, a combination of the size
8 and the expectation on the floor that there
9 was size there.
10 Q Because people on the floor knew
11 generally what your position was?
12 A Well, they know who the broker
13 is and when he starts doing size, their
14 expectation even today is that there is more
15 coming. Sometimes they are disappointed and
16 in this case they weren't.
17 Q And specifically in those
18 instances, knowing your size, they could
19 take advantage by forcing you to pay higher
20 prices than you otherwise would if you were
21 doing less size?
22 A Yes.
23 Q Mr. Walczak, I'm going to play
24 for you a document that's Bates stamped
25 Catalyst 003 23506 and the title of it as it

<p style="text-align: right;">Page 305</p> <p>1 Walczak</p> <p>2 been as it's been produced to us is National</p> <p>3 Open House Call, HFX CFH call, February 7,</p> <p>4 2017, so this falls right in that period</p> <p>5 that we were discussing earlier between</p> <p>6 February 1st and February 8th where, if I</p> <p>7 understand your testimony correctly, you</p> <p>8 were not entering into any trades, correct?</p> <p>9 A Correct.</p> <p>10 MR. WASSERMAN: We are starting</p> <p>11 the call a few seconds before a minute</p> <p>12 31 for the record.</p> <p>13 Q Before we play the call, what</p> <p>14 are these open house calls?</p> <p>15 A So I don't know if this</p> <p>16 particular one is different and relative to</p> <p>17 this period of time, it sounds like perhaps</p> <p>18 not, but I mentioned earlier that I was</p> <p>19 often called upon by Catalyst salespeople to</p> <p>20 help explain the mechanics of the strategy</p> <p>21 on phone calls. And as those phone calls</p> <p>22 became more frequent, we elected to do a</p> <p>23 national call for efficiency and consistency</p> <p>24 of the message that was delivered. I mean,</p> <p>25 this whole thing is all about transparency</p>	<p style="text-align: right;">Page 307</p> <p>1 Walczak</p> <p>2 always done in the history of the fund, is</p> <p>3 paying attention to our risk metrics.</p> <p>4 Q But which of those risk metrics</p> <p>5 specifically are designed to limit you to an</p> <p>6 eight percent drawdown?</p> <p>7 A None of the risk metrics in and</p> <p>8 of themselves are designed to limit the</p> <p>9 drawdown. It's an aspirational goal using</p> <p>10 these metrics in concert, which across 11</p> <p>11 years of market history were successful in</p> <p>12 limiting to at least close to our eight</p> <p>13 percent goal.</p> <p>14 Q But trying to -- you admit that</p> <p>15 you represent on this call that you are</p> <p>16 trying to limit yourself to an eight percent</p> <p>17 drawdown, correct?</p> <p>18 A Yes. Again, it's a goal, not at</p> <p>19 promise and the audience is sophisticated</p> <p>20 investors and I had that in mind when I</p> <p>21 spoke that way on the call.</p> <p>22 MR. SHANK: That was you</p> <p>23 speaking on the phone?</p> <p>24 THE WITNESS: Yes, it was.</p> <p>25 Q But you are representing that</p>
<p style="text-align: right;">Page 306</p> <p>1 Walczak</p> <p>2 and telling people like it is, so that's</p> <p>3 what we are trying to do here.</p> <p>4 Q Who is on the receiving end of</p> <p>5 these calls by you?</p> <p>6 A These would be financial</p> <p>7 advisers.</p> <p>8 Q And is it your understanding</p> <p>9 that at least some of these financial</p> <p>10 advisers have discretion over their clients'</p> <p>11 portfolios?</p> <p>12 A Sure, I think so.</p> <p>13 Q And the financial advisers can</p> <p>14 ask questions on the call, correct?</p> <p>15 A Yes.</p> <p>16 Q And you answer those questions,</p> <p>17 correct?</p> <p>18 A Yes.</p> <p>19 (Audio file was played.)</p> <p>20 Q Mr. Walczak, on February 7th at</p> <p>21 the time of this call, what were you doing</p> <p>22 to limit yourself to an eight percent</p> <p>23 drawdown?</p> <p>24 A I think it came across on the</p> <p>25 call, we were doing the same thing we have</p>	<p style="text-align: right;">Page 308</p> <p>1 Walczak</p> <p>2 that's your goal?</p> <p>3 A Yes.</p> <p>4 Q In order to have a goal of</p> <p>5 limiting yourself to any particular amount</p> <p>6 of loss, you would have to be looking at a</p> <p>7 metric that measures potential loss,</p> <p>8 correct?</p> <p>9 A No.</p> <p>10 Q Why not?</p> <p>11 A Because my experience with</p> <p>12 processes both in this business and prior,</p> <p>13 you set a framework to control a process and</p> <p>14 when you stick to that framework, you either</p> <p>15 get the results you desire or you don't and</p> <p>16 then you come back and measure the process.</p> <p>17 So if I'm filling Coke bottles at a thousand</p> <p>18 a minute and I want to get an output for a</p> <p>19 day, I know how I have to adjust the</p> <p>20 machine, but I have no metric about the goal</p> <p>21 at the end of the day. I know the process</p> <p>22 parameters that yield that result over time</p> <p>23 and that's what we have in place here.</p> <p>24 Q But, Mr. Walczak, in order to</p> <p>25 have a specific goal of limiting yourself to</p>

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1 Walczak
 2 an eight percent drawdown, don't you need to
 3 have a way of understanding what would cause
 4 an eight percent drawdown?
 5 A And I think I do, that was the
 6 original analysis and subsequent experience
 7 with the fund. Any number of these things,
 8 and especially putting them in concert, can
 9 lead to a greater drawdown if they are not
 10 adhered to.
 11 Q But what specifically are you
 12 doing to measure what a potential drawdown
 13 could be?
 14 A What I --
 15 Q Let me say that again. What
 16 specifically are you doing to measure the
 17 magnitude of what a potential drawdown could
 18 be?
 19 A That's in the monthly
 20 performance chart.
 21 Q That's backward-looking. What
 22 are you specifically doing to measure the
 23 magnitude of potential losses going forward?
 24 A I honestly don't consider that
 25 to be a prerequisite for something like

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1 Walczak
 2 this.
 3 Q But if you are not measuring the
 4 magnitude of potential losses, how are you
 5 achieving a goal to have a limit on the
 6 magnitude of those losses?
 7 A By putting in place the risk
 8 metric. All of these parameters, when
 9 adhered to, have delivered over time in real
 10 time the desired goal or certainly close to
 11 it.
 12 Q But you have acknowledged
 13 previously today that none of those metrics
 14 in Exhibit 5 measures potential losses of
 15 the portfolio?
 16 A That's correct.
 17 Q So how can you achieve a goal of
 18 limiting potential losses to the portfolio
 19 if you are not even measuring potential
 20 losses to the portfolio?
 21 A By adhering to this framework of
 22 risk parameters.
 23 Q But you've said that none of
 24 those risk parameters measures potential
 25 losses.

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1 Walczak
 2 A I don't understand why that's a
 3 prerequisite.
 4 Q Would you agree that in order to
 5 try to achieve a limit on potential losses,
 6 that you would need to have a tool for
 7 measuring potential losses?
 8 A No, I don't. What I would
 9 suggest is that you have to have a risk
 10 framework in place such that when you adhere
 11 to it and measure the results, the results
 12 fall into your desired goal.
 13 Q But your measurements were all
 14 backward-looking, correct?
 15 A They were -- well, they were the
 16 results of adhering in real time to these
 17 metrics and they represent not a
 18 hypothetical, what could happen if in the
 19 worst-case scenario, they represent what did
 20 happen across 11 or 12 years of market
 21 history by adhering to these metrics in real
 22 time. Again, not what if this is or what if
 23 that is, not a hypothetical, but a
 24 real-world example of whether or not this
 25 works.

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1 Walczak
 2 Q Does what happened in the past
 3 predict what's going to happen in the
 4 future?
 5 A It's the best forecast basis
 6 that I'm aware of.
 7 Q Why is that?
 8 A I can't explain it other than in
 9 terms of forecasting the future, I'm not
 10 sure there is a technique that's used other
 11 than to take data from the past and apply it
 12 to what might happen in the future.
 13 Q There is a metric for measuring
 14 how your portfolio will respond to a variety
 15 of future market conditions, correct?
 16 A Yes.
 17 Q And what is that metric?
 18 A Well, there are a number of
 19 metrics. I can look at Option View. I mean,
 20 that's what I would use.
 21 Q But none of those metrics were
 22 the ones that you were paying attention to
 23 in Exhibit 5?
 24 MR. MOYLE: Objection to the
 25 form of the question.

<p style="text-align: right;">Page 313</p> <p>1 Walczak</p> <p>2 A No --</p> <p>3 Q Do any of the metrics that you</p> <p>4 were using to try to limit yourself to an</p> <p>5 eight percent drawdown look at the potential</p> <p>6 performance of your portfolio or the</p> <p>7 predicted performance of your portfolio</p> <p>8 given certain movements in the market?</p> <p>9 A No.</p> <p>10 MR. SHANK: You were working off</p> <p>11 of a history of about ten years, right?</p> <p>12 THE WITNESS: (Indicating.)</p> <p>13 MR. SHANK: Is that a yes?</p> <p>14 THE WITNESS: Yes, sorry.</p> <p>15 MR. SHANK: Is it fair to say</p> <p>16 that any kind of market condition that</p> <p>17 didn't occur over the last ten years</p> <p>18 were not considered in your conclusion</p> <p>19 that your risk metrics were sufficient?</p> <p>20 THE WITNESS: In hindsight,</p> <p>21 that's -- I can agree with that.</p> <p>22 MR. SHANK: You never took any</p> <p>23 steps to test to see how your risk</p> <p>24 metrics would perform in other market</p> <p>25 conditions other than what was actually</p>	<p style="text-align: right;">Page 315</p> <p>1 Walczak</p> <p>2 things, that a number of them would</p> <p>3 have triggered and prevented the large</p> <p>4 drawdown in 2007. And in between,</p> <p>5 without going back and studying a chart</p> <p>6 and a performance record, I can't say.</p> <p>7 MR. SHANK: Is it fair to say</p> <p>8 that most of the time during that</p> <p>9 ten-year period you were not near your</p> <p>10 risk limits?</p> <p>11 THE WITNESS: Yes, that's fair.</p> <p>12 MR. SHANK: So for most of your</p> <p>13 ten-year history that you were working</p> <p>14 with, you didn't have positions on to</p> <p>15 the degree that you were pushing the</p> <p>16 limits of your risk metrics, correct?</p> <p>17 THE WITNESS: I would like to</p> <p>18 say that a different way because during</p> <p>19 that ten-year period, it was uncommon</p> <p>20 for market conditions to drive the</p> <p>21 portfolio to trigger a risk parameter,</p> <p>22 that would be a true statement.</p> <p>23 MR. SHANK: Can we just talk for</p> <p>24 one second?</p> <p>25 MR. WASSERMAN: Off the record.</p>
<p style="text-align: right;">Page 314</p> <p>1 Walczak</p> <p>2 occurring over the ten years that you</p> <p>3 were using it, correct?</p> <p>4 THE WITNESS: That's correct.</p> <p>5 And it gets back to the discussion of</p> <p>6 the value at risk is how you apply a</p> <p>7 back-testing of these sorts of metrics</p> <p>8 to a different environment, the same as</p> <p>9 how do you calculate a value at risk on</p> <p>10 this portfolio other than using</p> <p>11 historical methods, which is the same</p> <p>12 problem we are in in the discussion.</p> <p>13 MR. SHANK: Did you believe that</p> <p>14 ten years was a sufficient amount of</p> <p>15 time to draw conclusions that your risk</p> <p>16 metrics would limit losses to eight</p> <p>17 percent?</p> <p>18 THE WITNESS: Yes, I did.</p> <p>19 MR. SHANK: During that ten-year</p> <p>20 period, how often were you at or near</p> <p>21 your risk limits?</p> <p>22 THE WITNESS: Well, as I said,</p> <p>23 just from a recency standpoint, I know</p> <p>24 it occurred in 2016. I know that in</p> <p>25 2007 that was the source of these</p>	<p style="text-align: right;">Page 316</p> <p>1 Walczak</p> <p>2 (Whereupon, a discussion was</p> <p>3 held off the record.)</p> <p>4 Q Just a couple of additional</p> <p>5 questions, Mr. Walczak. Are you aware of</p> <p>6 whether sometime in 2015 investors were told</p> <p>7 that the fund would be implementing a soft</p> <p>8 close?</p> <p>9 A Yes. I don't remember exact time</p> <p>10 frame, but somewhere in there. I don't know</p> <p>11 if it's 2015, but there was a soft close</p> <p>12 that was talked about at some point.</p> <p>13 Q Were you involved in those</p> <p>14 discussions?</p> <p>15 A I didn't do anything -- I was</p> <p>16 aware that Catalyst wanted to soft close the</p> <p>17 fund and I was in agreement that it was a</p> <p>18 good thing to do, but I wasn't involved in</p> <p>19 the mechanics of communicating or making it</p> <p>20 happen.</p> <p>21 Q In late 2015, you were in</p> <p>22 agreement that a soft close was a good thing</p> <p>23 to do?</p> <p>24 A Yes.</p> <p>25 Q Why did you think it was a good</p>

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1 Walczak
2 thing to do?
3 A We were looking at FCM capacity
4 in terms of collateral and margin and the
5 FCM onboarding process is a fairly long
6 process, so we were concerned that the
7 growth rate of the fund would outstrip our
8 margin capability with our FCM's. So while
9 we weren't critical yet, I thought it was a
10 good idea to test the impact of a soft close
11 on those inputs.
12 Q Did you have any concerns in
13 late 2015 that implementing the strategy of
14 the fund would be increasingly risky as the
15 assets under management grew?
16 A I didn't perceive a risk around
17 the size other than execution quality, so we
18 did certainly monitor execution quality as
19 our trade sizes got bigger.
20 Q Do you know whether a soft close
21 was ever actually implemented?
22 A My recollection was that there
23 was an attempt to implement it, meaning
24 certain distribution platforms had the
25 capability mechanically to do it, certain

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1 Walczak
2 did not. So there was a soft close that for
3 some was on the honor system and that didn't
4 work very well. So that's what I remember
5 about the implementation of it.
6 Q So, to your knowledge, there was
7 never an actual soft close; is that correct?
8 A No, I believe there was. As I
9 said, some platforms had the ability to do
10 that, some did not. I think, again, I wasn't
11 in the middle of this, but I think it was
12 announced and I think there was an attempt
13 to implement it and then it wasn't possible
14 based on that platform issue to do it
15 uniformly.
16 Q What do you mean by "platforms"?
17 A Distribution platforms and this
18 is way out of my expertise, but where
19 advisers can invest client money in the fund
20 or make investments.
21 Q Vehicles through which clients
22 can invest money in the fund?
23 A Right. I guess an adviser is
24 going to be -- he's got to do his business
25 on a particular platform.

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1 Walczak
2 Q Are you involved at all in
3 Alpha-Centric?
4 A No.
5 MR. WASSERMAN: I have no
6 further questions.
7 Jeff, do you have additional
8 questions?
9 EXAMINATION BY
10 MR. SHANK:
11 Q Mr. Walczak, just curious, do
12 you believe you appropriately managed the
13 fund's risk throughout 2016 and early 2017?
14 A Yes, I do.
15 Q Do you believe you took an
16 appropriate amount of risk consistent with
17 the fund's objective and the representation
18 made to investors?
19 A I do.
20 Q Is there anything about your
21 trading decisions that with hindsight you
22 believe were not good decisions?
23 A With hindsight, I recognize that
24 the addition of the new risk metric accounts
25 for conditions we hadn't seen before in

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1 Walczak
2 terms of doing a better job of managing
3 risk. However, without that hindsight, as I
4 have said, my experience with how we manage
5 risk was appropriate and my responsibility
6 was to stick with what -- manage the fund
7 both from a risk standpoint and a nonrisk
8 standpoint, to manage the fund in the same
9 way that I had consistently done for ten or
10 11 years.
11 Q Were the market movements from
12 December to February 2016/2017 unprecedented
13 to what you had previously seen?
14 A Along certain dimensions, yes.
15 Q How so?
16 A The absence of mean reversion
17 and the degree of advance in the market.
18 Q The degree of advance in the
19 market was unprecedented over the last ten
20 years?
21 A Not unprecedented. Close in
22 terms of rates of advance over certain time
23 periods, they were certainly extremely rare.
24 Q And as far as volatility mean
25 reverted, was it your experience that

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1 Walczak
 2 volatility typically mean reverted over a
 3 period of weeks or even a month or two?
 4 A Well, actually what I meant was
 5 price mean reversion and that goes to the
 6 absence of any material pull-backs in the
 7 market.
 8 MR. WASSERMAN: You mean the
 9 price of the S&P?
 10 THE WITNESS: Yes.
 11 Q Can you provide us with any
 12 specifics as to how the market movements in
 13 early 2017 were unprecedented in your
 14 experience?
 15 A I don't have that data in front
 16 of me, but I think I can come up with some
 17 stats. We have got some things put together.
 18 Q Did you previously look at that?
 19 Did you previously analyze whether any of
 20 the things that happened were unprecedented
 21 in your experience?
 22 A I'm still not sure I understand.
 23 Q I'm trying to get a sense, when
 24 you say things are close to unprecedented,
 25 whether you are just going off your

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1 Walczak
 2 feeling or hunch or whether that's something
 3 you actually analyzed?
 4 A No, we have some analytical data
 5 on that, yes.
 6 Q Who has that?
 7 A I mean, Kimberly and our analyst
 8 put it together. I think we actually may
 9 even have given it to Catalyst.
 10 MR. SHANK: Obviously we would
 11 like to make a request for production.
 12 MR. MOYLE: It has already been
 13 produced.
 14 MR. SHANK: Maybe you can get a
 15 Bates number.
 16 MR. MOYLE: Now you are asking
 17 for a lot. We will talk.
 18 MR. SHANK: Is there anything
 19 else you would like to add --
 20 MR. WASSERMAN: Can I ask?
 21 MR. SHANK: Sure.
 22 FURTHER EXAMINATION
 23 BY MR. WASSERMAN:
 24 Q In light of your answer, in the
 25 period of February 1st to February 8th, are

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1 Walczak
 2 you expecting mean reversion in the market?
 3 A Yes. As I mentioned, I think we
 4 had one of the exhibits, the email
 5 demonstrates the type of thing -- that was
 6 an unsolicited email from Kimberly about the
 7 type of thing we look at a daily basis, she
 8 pointed out a few things. So the market
 9 during that period of time was essentially
 10 flat. Our expectation was flat to lower
 11 based on things like she commented on. So
 12 that was the expectation we were operating
 13 under.
 14 MR. SHANK: But a flat market is
 15 generally not unprecedented, right?
 16 THE WITNESS: Right. You are
 17 correct, we did not anticipate the
 18 unprecedented.
 19 Q In the days prior to February
 20 9th, were you and Kimberly using historical
 21 data to try to make an assessment of the
 22 probability of how the market would move
 23 over the next few days?
 24 A That's generally what we do. So
 25 we were certainly looking at things like the

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1 Walczak
 2 ones she described and others.
 3 MR. WASSERMAN: Can we mark this
 4 as Exhibit 15?
 5 (Photocopy of email, dated
 6 January 13, 2017, was marked Commission
 7 Exhibit 16 for identification, as of
 8 this date.)
 9 Q This is a document Bates stamped
 10 Catalyst 003 00222. Mr. Walczak, can you
 11 take a moment and review the document?
 12 MR. WASSERMAN: While he is
 13 reviewing it, for the record, the
 14 document reflects an email dated
 15 January 13, 2017 from Mr. Walczak to
 16 Kimberly Rios with the subject line
 17 "Market Tells."
 18 A Okay.
 19 Q Mr. Walczak, do you recall
 20 sending this email to Kimberly?
 21 A I don't recall it specifically,
 22 but certainly I did.
 23 Q What's VXO?
 24 A VXO is the implied volatility
 25 calculation for the S&P 100 as opposed to

<p style="text-align: right;">Page 325</p> <p>1 Walczak</p> <p>2 the S&P 500. It's also the predecessor to</p> <p>3 the VIX. So when historical numbers are</p> <p>4 looked at, prior to the VIX being</p> <p>5 calculated, you look at the VXO. There is a</p> <p>6 calculation change. Anyway, that's what it</p> <p>7 is currently today.</p> <p>8 Q The email states, "Thursday</p> <p>9 marked the 42nd consecutive session VXO</p> <p>10 closed under the 15 level. That's only</p> <p>11 occurred on a dozen other occasions since</p> <p>12 1990. The S&P was twice as likely to fall by</p> <p>13 the time the VXO rose back above the 15</p> <p>14 level." And Kimberly indicates that of the</p> <p>15 12, four were up and eight were down.</p> <p>16 A Well, if I can just interrupt so</p> <p>17 you understand this email, this is a cut and</p> <p>18 paste done by me from one of our research</p> <p>19 providers.</p> <p>20 Q Do you recall which research</p> <p>21 provider?</p> <p>22 A Market Tells. So this is not</p> <p>23 either Kimberly or I making these</p> <p>24 statements.</p> <p>25 Q Is this the type of information</p>	<p style="text-align: right;">Page 327</p> <p>1 Walczak</p> <p>2 go down?</p> <p>3 A Yes. Again, for clarity, none of</p> <p>4 this is my words, it's cut and paste from</p> <p>5 our research provider.</p> <p>6 Q And these are the type of data</p> <p>7 points that you were looking at in the first</p> <p>8 week of February to draw a conclusion as to</p> <p>9 the probability of the market going up or</p> <p>10 down?</p> <p>11 A This is an example, as I</p> <p>12 mentioned in a previous part of the</p> <p>13 testimony, this is an example of what I'm</p> <p>14 calling price patterns. We use other</p> <p>15 research providers for sentiment data and</p> <p>16 then some very mechanical technical measures</p> <p>17 like the Bollinger Bands and RSI.</p> <p>18 Q And were those types of metrics</p> <p>19 influencing your decision to trade or not to</p> <p>20 trade in early February?</p> <p>21 A Yes, I take these into account</p> <p>22 when I do make trading decisions.</p> <p>23 MR. WASSERMAN: I have no</p> <p>24 further questions.</p> <p>25 Q Is there anything you would like</p>
<p style="text-align: right;">Page 326</p> <p>1 Walczak</p> <p>2 that, as you testified a few minutes ago,</p> <p>3 you were looking at to try to determine the</p> <p>4 probability of the market moving up or down</p> <p>5 over the following couple of days?</p> <p>6 A Yes.</p> <p>7 Q What was this paragraph telling</p> <p>8 you?</p> <p>9 A Well, the paragraph -- the first</p> <p>10 paragraph was not especially relevant to the</p> <p>11 near future because the first paragraph</p> <p>12 refers to a study on a much longer time</p> <p>13 horizon. However, it still casts a somewhat</p> <p>14 negative outlook going forward even on that</p> <p>15 longer time frame. The second paragraph</p> <p>16 refers to January options expiration week,</p> <p>17 so that was the really valuable piece of</p> <p>18 this.</p> <p>19 Q And in that particular</p> <p>20 paragraph, you say, "Next week is options</p> <p>21 expiration week and it's interesting to note</p> <p>22 that since 2000, January Op Ex weeks have</p> <p>23 had a decidedly negative tone." Would that</p> <p>24 be a signal to you that in the week before</p> <p>25 the January expiry, the market was likely to</p>	<p style="text-align: right;">Page 328</p> <p>1 Walczak</p> <p>2 to clarify for the record?</p> <p>3 A No.</p> <p>4 MR. WASSERMAN: The guys on the</p> <p>5 phone, do you guys have something you</p> <p>6 need to add.</p> <p>7 MR. BENSON: My name is David</p> <p>8 Benson, I'm an attorney in the</p> <p>9 enforcement division. We don't have</p> <p>10 anything to offer, to add, but I just</p> <p>11 want to read Mr. Walczak our standard</p> <p>12 conclusion paragraph.</p> <p>13 THE WITNESS: Sure.</p> <p>14 MR. BENSON: I can do that now</p> <p>15 or I can wait.</p> <p>16 MR. WASSERMAN: No, please go</p> <p>17 ahead.</p> <p>18 MR. BENSON: So, Mr. Walczak, we</p> <p>19 have no further questions for you at</p> <p>20 this time. We may, however, call you</p> <p>21 again in connection with this</p> <p>22 investigation. Should this be</p> <p>23 necessary, we will contact your</p> <p>24 counsel.</p> <p>25 Before we close the record, from</p>

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Walczak

our perspective, do you wish to clarify anything or add anything to the statements that you have made today, Mr. Walczak?

THE WITNESS: No.

MR. BENSON: Thank you very much.

Counsel, do you wish to ask any clarifying questions of your client, Mr. Walczak?

MR. MOYLE: Not at this time, thank you.

MR. WASSERMAN: Mr. Walczak, as a final note, we would request that you not discuss the contents of our conversation here today with anybody else. Our investigations are confidential and so we make that request.

MR. MOYLE: Outside of counsel.

MR. WASSERMAN: Outside of counsel, thank you. We can go off the record.

(Whereupon, a discussion was

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ACKNOWLEDGEMENT

UNITED STATES OF AMERICA)

ss:

COMMODITY FUTURES TRADING COMMISSION)

I, EDWARD WALCZAK, hereby certify that I have read the transcript of my testimony taken under oath in my deposition of October 27, 2017; that the transcript is a true, complete and correct record of what was asked, answered and said during this deposition, and that the answers on the record as given by me are true and correct.

EDWARD WALCZAK

Subscribed and sworn to before me this ____ day of _____, 2017.

NOTARY PUBLIC

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held off the record.)

MR. WASSERMAN: Just a brief administrative note for the record. The February 7th open house call that we played, Bates stamped Catalyst 003 23506, we will mark as Exhibit 16. (Photocopy of CD containing an audio file was marked Commission Exhibit 16 for identification, as of this date.)

MR. WASSERMAN: We can close the record.

(Time noted: 5:45 p.m.)

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1
2 CERTIFICATE
3 STATE OF NEW YORK)
ss:
4 COUNTY OF SUFFOLK)
5 I, CATHERINE J. BERKERY, a
6 Shorthand Reporter and Notary Public in
7 and for the State of New York, do hereby
8 certify:
9 That the testimony of EDWARD
10 WALCZAK was held before me at the
11 aforesaid time and place. That said
12 witness was duly sworn before the
13 commencement of the testimony and that the
14 testimony was taken stenographically by me
15 and is a true and accurate transcription
16 of my stenographic notes.
17 I further certify that I am not
18 related to any of the parties to the
19 action by blood or marriage and that I am
20 in no way interested in the outcome of
21 this matter.
22 IN WITNESS WHEREOF, I have hereunto
23 set my hand this 3rd day of November 2017.
24
25 Catherine J. Berkery

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1
2 ERRATA SHEET
3 DEPOSITION OF: EDWARD WALCZAK
RE: CATALYST CAPITAL ADVISERS
4 DATE TAKEN: October 30, 2017
5 PAGE LINE # CORRECTION REASON
6 _____
7 _____
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19 _____
20 _____
EDWARD WALCZAK
21
22 Subscribed and sworn to
before me this ____ day
of _____, 2017.
23
24 _____
NOTARY PUBLIC
25

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